UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JINO KURIAKOSE, Individually and on Behalf of All Others Similarly Situated, Plaintiff, vs. FEDERAL HOME LOAN MORTGAGE CORPORATION, RICHARD SYRON, PATRICIA L. COOK, and ANTHONY S. PISZEL, Defendants.	)	CIVIL ACTION NO. 1:08-cv-7281 (JFK)

MEMORANDUM OF LAW IN SUPPORT OF FREDDIE MAC'S
MOTION TO DISMISS THE AMENDED COMPLAINT WITH PREJUDICE

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INTRODUCTION

This litigation is exactly the type of baseless securities "strike suit" that the Private Securities Litigation Reform Act of 1995 ("PSLRA") was designed to prevent. Congress enacted the PSLRA to deter "baseless and extortionate securities lawsuits." H.R. Rep. No. 104-369, at 32 (1995) (Conf. Rep.), as reprinted in 1995 U.S.C.C.A.N. 730, 731. The legislation was:

> prompted by significant evidence of abuse in private securities lawsuits . . . [which] include . . . the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in the issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action[.]

Id. at 31, as reprinted in 1995 U.S.C.C.A.N. at 730 (emphasis added). "[T]he congressional intent of the PSLRA [is] to deter strike suits wherein opportunistic private plaintiffs file securities fraud claims of dubious merit in order to exact large settlement recoveries." Lentell v. Merrill Lynch & Co., 396 F.3d 161, 171 (2d Cir. 2005) (citation and quotation omitted).

It is common knowledge that, beginning in the latter half of 2007, this country entered a period of unprecedented financial turmoil. Real estate values plummeted, and credit markets froze.[1] Just as the Federal Home Loan Mortgage Corporation ("Freddie Mac") had warned investors, its financial results and its stock price suffered after those macroeconomic events unexpectedly tore through the U.S. economy. Indeed, virtually every major financial institution in the country was surprised by these historically anomalous developments and incurred losses similar to, or greater than, those incurred by Freddie Mac.

It is thus not surprising that Plaintiff's claims fail to satisfy the pleading requirements set forth in the PSLRA and Federal Rules of Civil Procedure 9(b) and 12(b)(6). Indeed, as discussed below: (1) Plaintiff fails sufficiently to plead loss causation (see infra Part I); (2) Plaintiff fails to plead with particularity which statements are allegedly false or why (see infra Part II.A); (3)

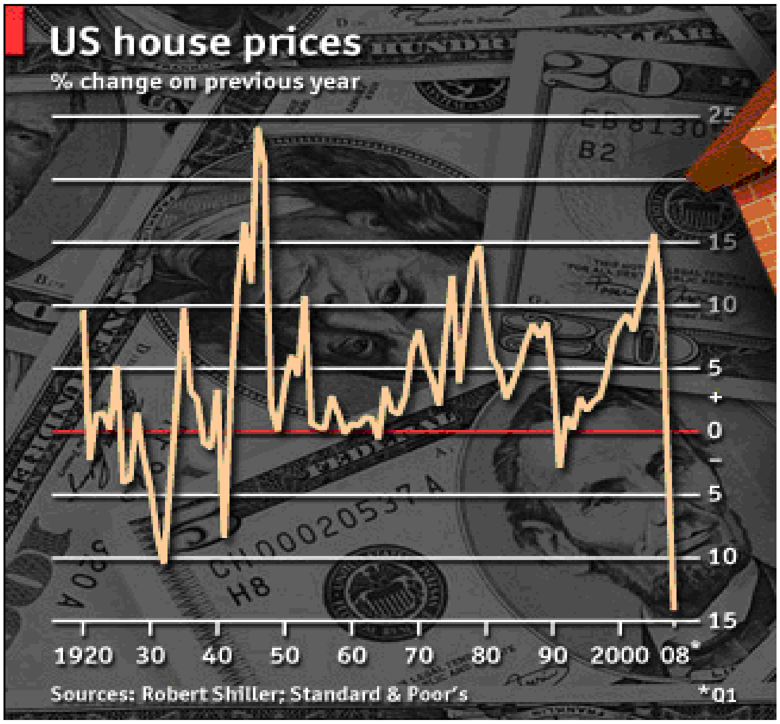
[1] See App. 54 at 1, 23-25, 37-38 (Board of Governors of the Federal Reserve System, Monetary Policy Report to the Congress, Feb. 27, 2008 (describing steep drop of credit market in July - Aug. 2007)). This Court may take judicial notice of market phenomena. See, e.g., In re 2007 Novastar Fin., Inc., Sec. Litig., No. 07-0139, 2008 WL 2354367, at *1 (W.D. Mo. June 4, 2008) (taking judicial notice of reversals in the housing industry) (applying Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007)), aff'd, 2009 WL 2747281 (8th Cir. Sept. 1, 2009). The Appendix filed herewith contains complete copies of documents referenced herein as "App. __."

Plaintiff fails sufficiently to allege scienter (see infra Part II.B); and (4) none of the statements Plaintiff challenges is actionable as a matter of law (see infra Part III).

Plaintiff's claims are, at best, nothing more than allegations of "fraud by hindsight," and such contentions cannot serve as the basis for a securities fraud action. "[H]indsight does not establish fraud. If it did, any drop in the price of shares would result in lawsuits from disappointed investors. The market has risks; the securities laws do not serve as investment insurance." Raab v. General Physics Corp., 4 F.3d 286, 291 (4th Cir. 1993) (affirming dismissal of federal securities fraud claims). "Investment insurance" -- to which Plaintiff is not entitled -- is plainly what Plaintiff is looking for here.

PRELIMINARY STATEMENT

Freddie Mac is a government-sponsored enterprise ("GSE") chartered by Congress in 1970 to promote homeownership by providing liquidity, stability and affordability to the home mortgage market. Plaintiff's Amended Consolidated Complaint ("Amended Complaint" or "AC") ¶ 64. To meet its Congressionally mandated mission, Freddie Mac purchases mortgages and mortgage-related securities, thereby providing a flow of capital to mortgage lenders. See id. Earlier in this decade, real estate values skyrocketed nationwide. Freddie Mac repeatedly and extensively warned investors that, if real estate values declined, or credit tightened, or interest rates changed, it was likely to incur unavoidable losses. Then, in 2007, this country was blindsided by the single largest decline in single-home values in recorded history. App. 1 (Dropping a Brick, The Economist (May 29, 2008)). This dramatic rise and sudden drop in U.S. home values is illustrated by the chart below:



Events leading up to the filing of this case -- and particularly the actions of plaintiff's counsel -- highlight the extent to which it is nothing more than a lawyer-driven strike suit. On November 20, 2007, Freddie Mac announced $2 billion in losses, which announcement triggered a spate of securities class actions and derivative lawsuits. The very next day, Coughlin Stoia -- the same law firm that represents Plaintiff in this action -- filed a securities class action against Freddie Mac and its management, alleging that the "defendants made false and misleading statements concerning Freddie Mac's business, its risk management and the procedures it put into place to protect the Company from problems in the mortgage industry." Compl. ¶ 3, Reimer v. Federal Home Loan Mortgage Corp., No. 07-10526 (S.D.N.Y.) (Keenan, J.) ("Reimer"). Coughlin Stoia further alleged that, the very same day that the asserted class period in this case ("Kuriakose") begins (i.e., November 20, 2007), Freddie Mac's alleged "misrepresentations and fraudulent conduct **became apparent to the market**[.]" Reimer Compl. ¶ 55 (emphasis added).

Notwithstanding Coughlin Stoia's contention that "the truth was revealed" on November 20, 2007, Reimer Compl. ¶ 3, after they were unable to secure lead counsel status against Freddie Mac and the Individual Defendants in connection with the Reimer case, Coughlin Stoia voluntarily dismissed that case (see Reimer, Dkt. Nos. 6, 8) and filed this belated

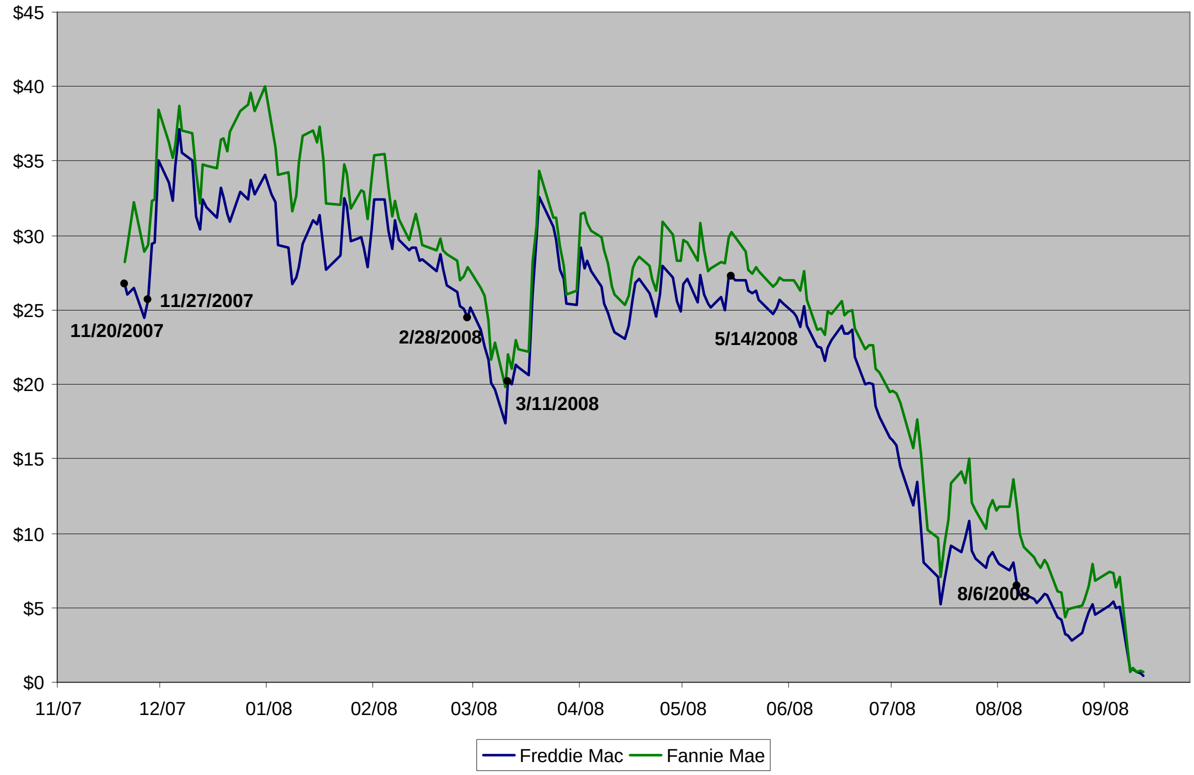
action -- suddenly contending that shareholders were injured **after** "the truth was revealed" on November 20, 2007. Coughlin Stoia's transparent attempt to achieve some role in securities class action litigation against Freddie Mac, however unfounded, is readily apparent, as their complaint here simply mirrors the allegations contained in their earlier Reimer Complaint, but for a time period **after** the alleged truth was revealed. Compare Letter from David J. George to Hon. John F. Keenan (Mar. 30, 2009) at 1 (Dkt. No. 97) (summarizing the Kuriakose complaint, counsel asserted that "Defendants misrepresented the Company's exposure to mortgage-related losses, poor underwriting standards and risk management procedures and the resulting negative impact to its capital adequacy."), with Reimer Compl. ¶ 55 (alleging that Freddie Mac's "misrepresentations and fraudulent conduct" regarding those same matters allegedly "**became apparent to the market**" on November 20, 2007) (emphasis added).

Notably, Coughlin Stoia does not in this case represent a single shareholder who purchased Freddie Mac stock before November 20, 2007. Rather, every shareholder who purchased Freddie Mac stock during the putative class period in **this** case (beginning on November 20, 2007) did so **on or after** the date when, according to their own counsel, the entire market had already learned the truth regarding a supposed fraud at Freddie Mac.

Thus, it should come as no surprise that the AC is exceedingly long on rhetoric and short on substance. In particular, the performance of Freddie Mac's stock price over the course of the putative class period underscores the extent to which this case is a mere strike suit. Plaintiff fails to identify any fraud that ever inflated Freddie Mac's stock price, let alone a fraud that, when revealed, caused stock price declines. Notably, Plaintiff repeatedly alleges that Defendants' allegedly fraudulent statements were followed by **declines** in -- and not inflation of -- the Company's stock price. See, e.g., AC ¶¶ 450, 455, 464, 484, 487, 517.

Here, it is readily apparent that Freddie Mac's losses were caused by an industry-wide collapse, culminating in a government-imposed conservatorship, not any ostensible fraud. As the following chart depicts, Freddie Mac's stock price moved hand-in-hand with the stock price of its competitor GSE, Fannie Mae, including both ascents and declines:

Stock Price Performance of Freddie Mac and Fannie Mae
11/20/07 - 9/12/08



Plaintiff is unable to allege that its losses were caused by anything other than the drumbeat of negative news impacting the GSEs. As this Court has observed, where a plaintiff cannot plead that its losses resulted from the fraud, rather than intervening causes such as the collapse of a market sector, plaintiff has failed to plead loss causation. In re Merrill Lynch & Co. Research Reports Sec. Litig., 568 F. Supp. 2d 349, 360 (S.D.N.Y. 2008) (Keenan, J.) (dismissing claims with prejudice for failure to plead loss causation).

In the end, the reason that this case should be dismissed is not very complicated. Freddie Mac's principal assets are home mortgages and mortgage-backed securities. As Freddie Mac repeatedly warned investors, a decline in home values was likely to cause Freddie Mac to recognize losses and to affect its capital adequacy. In November 2007, the steepest decline in home values in U.S. history led Freddie Mac to begin recognizing losses. The unforeseen financial crisis that followed -- which materially worsened in the third quarter of 2008 -- resulted

in further losses to Freddie Mac and virtually every other major financial institution worldwide. Failing to predict the timing and magnitude of a historically unprecedented drop in housing prices and the recent financial crisis is not fraud.[2] Moreover, none of the Individual Defendants, Freddie Mac's former CEO, CFO, and COO, sold **a single share** of stock during the class period. To the contrary, during that time the value of their own Freddie Mac stock holdings collectively **declined** by **over $40 million**, which negates any inference of fraudulent intent. Plaintiff's claims should be dismissed, with prejudice.

FACTS

Freddie Mac's Mission

Freddie Mac's statutory "mission is to provide liquidity, stability and affordability to the United States housing market." AC ¶ 64; App. 2 at 1 (2006 Annual Report).[3] Freddie Mac fulfills its mission by purchasing home mortgages from financial institutions such as banks and mortgage companies. See German v. Fed. Home Loan Mortgage Corp., 885 F. Supp. 537, 544 (S.D.N.Y. 1995); see also AC ¶ 64. Freddie Mac packages those mortgages into securities that it sells in the capital markets (its "Guarantee Portfolio"), and it also purchases mortgage-related securities created by others (its "Retained Portfolio"), thereby facilitating the flow of funds between the capital and mortgage markets. See AC ¶ 65; App. 7 at 1 (2007 Annual Report). Under its charter, Freddie Mac was allowed to purchase a variety of mortgages and mortgage-backed securities, but it was required to meet certain affordable housing goals set by the

[2] See, e.g., In re PXRE Group, Ltd., Sec. Litig., 600 F. Supp. 2d 510, 546 (S.D.N.Y. 2009) ("Taken collectively, Plaintiff's factual allegations suggest an industry, and a company, shocked by a unique and devastating catastrophe."); In re Huntington BancShares, Inc. ERISA Litig., 620 F. Supp. 2d 842, 853 (S.D. Ohio 2009) (dismissing "stock drop case[]" where company's financial difficulties were part of the "economic climate in general, which of course includes the subprime lending crisis"); In re Citigroup Inc. S'holder Deriv. Litig., 964 A.2d 106, 139 (Del. Ch. 2009) (dismissing derivative claim where defendant's losses were "a result of the recent problems in the United States economy, particularly those in the subprime mortgage market"); see also Pittleman v. Impac Mortgage Holdings, Inc., No. 07-0970, slip op. at 6 (C.D. Cal. Mar. 9, 2009) ("This case is about a company involved in a volatile industry at the onset of a long, destructive economic downturn.").

[3] See also 12 U.S.C. § 4501 (Freddie Mac has "an affirmative obligation to facilitate the financing of affordable housing for low- and moderate-income families in a manner consistent with their overall public purposes, while maintaining a strong financial condition and a reasonable economic return").

Department of Housing and Urban Development ("HUD").[4]

In 2004, HUD stated that "[i]ncreasing homeownership [was] a national priority," and it increased Freddie Mac's home purchase subgoals to "levels at or near the high end of the estimated market range for each goal category by 2008." App. 47 (69 Fed. Reg. 63,581, 63,597 (Nov. 2, 2004)).[5] As a means of achieving these higher goals, HUD urged Freddie Mac to increase its participation in the subprime market. As HUD stated: "If the GSEs reach deeper into the subprime market, more borrowers will benefit from the advantages that greater stability and standardization create." Id. at 63,601.[6]

Nonetheless, at the onset of the class period, the vast majority of mortgage loans held by Freddie Mac were traditional mortgage loans, not "non-traditional" products such as subprime or Alt-A loans.[7] In fact, only approximately 1% of the loans in Freddie Mac's $1.7 trillion dollar Guarantee Portfolio were subprime, and more than 90% were traditional, prime mortgages. See App. 14 at 8 (Nov. 20, 2007 Conference Call Tr.) (1% characterized as having FICO scores less than 620 and loan to value ratios greater than 90%). Likewise, almost 80% of Freddie Mac's Retained Portfolio consisted of traditional, prime loans. See id. at 22 (non-agency investments[8] backed by subprime loans were only 15% and those backed by Alt-A loans were only 7%).

Moreover, when Freddie Mac increased its participation in the subprime mortgage

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[4] The goals and subgoals HUD set for Freddie Mac were "intended to expand housing opportunities for low- and moderate-income families, low-income families living in low-income areas, very low-income families and families living in HUD-defined underserved areas." App. 7 at 7-8 (2007 Annual Report).

[5] HUD previously set housing goals every few years, and the housing goal targets for 2005-2008 increased substantially from the 2001-2004 period. See App. 47 at Table 1 (69 Fed. Reg. at 63,590).

[6] At that time, Freddie Mac "cautioned that the struggle to meet high goals for low-income groups could cause the GSEs to relax underwriting standards and/or extend loans to people who are unprepared." App. 47 (69 Fed. Reg. at 63,601). Nonetheless, consistent with its mission, Freddie Mac bore an obligation to comply with HUD's directive and provided further support for the subprime market. Indeed, pursuant to the applicable federal regulations, HUD had the authority to take enforcement action against Freddie Mac in the event it failed to meet any feasible goal or subgoal that HUD had set. App. 7 at 9 (2007 Annual Report); see also 12 U.S.C. § 4566 (monitoring and enforcing compliance with housing goals) (pre-amendment).

[7] Although there is no universally accepted definition of Alt-A loans, many industry participants classify loans as Alt-A where the underwriting process has been streamlined in order to reduce the documentation requirements of the borrower or to allow alternative documentation. App. 7 at 94 (2007 Annual Report).

[8] Non-agency investments include all loans or mortgage-backed securities not guaranteed by Freddie Mac, Fannie Mae or any like government agency. See App. 7 at 5 (2007 Annual Report).

market, it did so in the most prudent way possible, i.e., by purchasing AAA-rated bonds backed by subprime loans. Such bonds bear far less risk than subprime or other collateralized debt obligations (CDO's), portfolios of subprime whole loans, or even other, lower-rated tiers of bonds backed by subprime loans. See App. 2 at 69 (2006 Annual Report) (disclosing that the $124 billion and $139 billion of non-agency mortgage-related securities backed by subprime loans held in 2005 and 2006, respectively, included "significant credit enhancement based on their structure and more than 99.9 percent of these securities were rated AAA at December 31, 2006.") (emphasis added). AAA bonds receive "[t]he highest rating assigned by [a] rating agency[, and their] [c]apacity to pay interest and repay principal is extremely strong[,]" due to the debt subordination that underlies and protects the AAA level. App. 49 (Kenneth G. Lore, Mortgage-Backed Sec.: Dev. & Trends in the Secondary Mortgage Market (2007-08 ed.)). As HUD specifically acknowledged, Freddie Mac has "been prudent in [its] pursuit of subprime lending, focusing on the top part of the market." App. 47 (69 Fed. Reg. at 63,601).[9]

Freddie Mac's Extensive Warnings To
Investors Regarding The Risks Inherent In Its Business

Freddie Mac warned investors extensively of the numerous risks it faced, including the risks posed by a decline in home values, interest rate changes, a tightening of credit and its affordable housing mission. For example, in its 2007 Annual Report, Freddie Mac warned investors of risks posed by a continued decline in U.S. housing prices and about the declining trend in U.S. house price appreciation and its potential impact on Freddie Mac's earnings:

> ***A continued decline in U.S. housing prices or other changes in the U.S. housing market could negatively impact our business and earnings.*** The national averages for new and existing home prices in the U.S. declined in 2007 for the first time in many years. This decline follows a decade of strong appreciation and dramatic price increases in the past few years. ***A continued declining trend in home price appreciation in any of the geographic markets we serve could result in a continued increase in delinquencies or defaults and a level of credit-related losses . . . which could significantly reduce our earnings***.

[9] It was not until 2008 that the ratings of Freddie Mac's bonds were lowered by the ratings agencies. See App. 7 at 14 (2007 Annual Report) ("Approximately $17.3 billion of non-agency mortgage-related securities in our retained portfolio backed by Alt-A and subprime mortgage loans were downgraded to ratings below AAA by at least one nationally recognized statistical rating organization between January 1, 2008 and February 25, 2008.").

App. 7 at 15 (2007 Annual Report) (emphasis added). Similarly, Freddie Mac warned investors that it might take a charge to its earnings if changes in housing prices or interest rates caused higher credit losses. See App. 7 at 14 (2007 Annual Report).

Freddie Mac also cautioned investors that if, among other things, house prices declined, such a decline could adversely affect the adequacy of its regulatory capital:

> Factors that could adversely affect the **adequacy of our regulatory capital** for future periods include . . . changes in the economic environment, such as large interest-rate or **implied volatility moves or house-price declines** . . . .

App. 2 at 130 (2006 Annual Report) (emphasis added). Indeed, Freddie Mac specifically cautioned investors not only respecting the many factors that could adversely affect its capital levels, but also the risk that it might not attain its capital surplus target:

> ***Market uncertainty and volatility may adversely affect our business, profitability, results of operations and*** *capital management*. . . . Mortgage market conditions and volatility have also adversely affected our capital levels, including our ability to manage to the 30% mandatory target capital surplus. **Factors that could adversely affect the adequacy of our capital for future periods include GAAP net losses; continued declines in home prices; changes in our credit and interest-rate risk profiles; adverse changes in interest-rate or implied volatility; adverse OAS changes; legislative or regulatory actions that increase capital requirements; or changes in accounting practices or standards**. . . . Our ability to execute any of these actions or their effectiveness may be limited and we might not be able to manage to the [30%] mandatory target capital surplus.

App. 7 at 11, 13-14 (2007 Annual Report) (emphasis added).[10]

A Steep Rise And Sudden Decline In Housing Prices
Rocked The Financial Industry In Late 2007 And Throughout 2008

From 1997 through 2006, housing prices increased at an "unusually rapid rate," far "more quickly than is customary" nationwide. App. 48 at 6 (Mortgage Bankers Ass'n, Housing & Mortgage Markets: An Analysis, Sept. 6, 2005). In fact, home prices nationwide "rose about 85% from 1997 to 2006 adjusted for inflation;" making it the "biggest national housing boom in U.S. history." App. 58 (Emily Freidlander, Yale's Shiller: U.S. Housing Slump May Exceed Great Depression, Wall St. J. Online, Apr. 22, 2008).

[10] Freddie Mac provided similar warnings in its Financial Report for the Three Months Ended Mar. 31, 2008. App. 9 at 102 (Supp. to 2007 Information Statement and Annual Report (May 14, 2008)).

This unusually steep increase in house prices came to an abrupt end in 2007. See supra pp. 2-3. Even in mid-2007, however, few predicted the extent to which house prices would decline. Indeed, as Reuters reported on April 20, 2007: "U.S. Treasury Secretary Henry Paulson said on Friday the housing market correction appears to be at or near its bottom and that trouble in the subprime mortgage market will not likely spread throughout the economy."[11] Of course, Secretary Paulson did not have the benefit of a crystal ball, and neither did Freddie Mac.

In 2007, house prices ultimately fell far more sharply than ever before in U.S. history. See supra pp. 2-3. In the third quarter of 2007, and the month of October 2007, in particular, the year-over-year housing-price declines nationwide were the largest on record. Id. When home values plummeted, credit tightened severely and loan defaults increased dramatically. Id.

Prior to late 2007, however, market regulators and participants viewed the impact of the subprime mortgage market's decline as limited:

- In March 2007, Federal Reserve Director of Banking Supervision and Regulation Roger T. Cole stated that "***at this time, we are not observing spillover effects from the problems in the subprime market to traditional mortgage portfolios or, more generally, to the safety and soundness of the banking system***." App. 50 at 1 (Subprime Mortgage Market: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs, 110th Cong. 1 (Mar. 22, 2007) (statement of Roger T. Cole)) (emphasis added).
- In March 2007, Federal Reserve Chairman Ben Bernanke stated that "***the impact on the broader economy and financial markets of the problems in the subprime market seem likely to be contained***." App. 51 at 2 (The Economic Outlook: Hearing before the S. J. Economic Comm., 110th Cong. 1-2 (Mar. 28, 2007) (testimony of Ben S. Bernanke, Chairman of the Federal Reserve)) (emphasis added).
- In July 2007, Treasury Secretary Henry Paulson stated that he believed that ***the housing market correction was "at or near the bottom***" and that ***the financial markets remained generally healthy***. App. 53 at 1-2 (Emily Kaiser, Paulson Sees U.S. Housing Downturn Near End, Reuters, July 2, 2007) (emphasis added).

Not surprisingly, the precipitous decline in house prices and the tight credit market caused massive losses across the entire financial industry, including at the country's largest and most respected mortgage lenders and investors. See App. 43 (Chart of Write-Downs and Credit Losses at Major Financial Institutions). After these losses were booked and announced, and after

[11] See App. 52 (Treasury's Paulson -- Subprime Woes Likely Contained, Reuters Bus. & Fin., Apr. 20, 2007). The Court may consider background material, without placing any evidentiary reliance on its contents, and "not run afoul of the rule that a district court must confine itself to the four corners of the complaint when deciding a motion to dismiss under Rule 12(b)(6)." Kramer v. Time Warner Inc., 937 F.2d 767, 773 (2d Cir. 1991).

the sale of Bear Stearns to JPMorgan Chase in mid-March 2008,[12] many commentators believed the credit crisis had subsided, and that the worst might be over.[13] As late as mid-July 2008, market watchers did not believe that the danger to financial institutions would approach the levels seen in the banking crisis of the late 1980s and early 1990s, let alone in the Great Depression. See, e.g., App. 62 (Andrew Ross Sorkin, After IndyMac Failure, Analysts Ask Who's Next, N.Y. Times (DealBook), July 14, 2008) ("The nation's banks are in far less danger than they were in the late 1980s and early 1990s, when more than 1,000 federally insured institutions went under during the savings-and-loan crisis.").[14]

As we now know, however, Bear Stearns was just the first of a handful of household names to buckle under the weight of the market crisis:

- On September 14, 2008, Merrill Lynch announced it would sell itself to Bank of America for $50 billion -- half of its estimated value in 2007.[15]
- On September 15, 2008, after Lehman Brothers' stock plummeted more than 70% from the beginning of the year to less than $1 per share,[16] the investment firm filed for Chapter 11 bankruptcy protection.[17]
- On September 16, 2008, the Federal Reserve took the extraordinary step of providing AIG with an $85 billion emergency loan in exchange for nearly 80 percent of AIG's shares.[18]
- On September 25, 2008, Washington Mutual became the largest bank in U.S. history to fail when it was seized by the FDIC -- its stock price falling to less than $0.10 per share, down from more than $35 per share a year earlier.[19]
- On September 29, 2008, Citigroup agreed to acquire the banking operations of

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[12] App. 56 (Andrew Ross Sorkin and Landon Thomas Jr., JPMorgan Acts to Buy Ailing Bear Sterns at Huge Discount, N.Y. Times, Mar. 16, 2008).

[13] See, e.g., App. 59 at 1 (Cyril Moulle-Berteaux, The Housing Crisis Is Over, Wall St. J., May 6, 2008 (op-ed) ("[I]t is very likely that April 2008 will mark the bottom of the U.S. housing market. Yes, the housing market is bottoming right now.")).

[14] This $125 billion figure -- quoted in July 2008 -- is dwarfed by the current bill for the federal bailout, which by one common measure now stands at $9.7 trillion. See App. 76 (Mark Pittman & Bob Ivry, U.S. Taypayers Risk $9.7 Trillion on Bailout Programs, Bloomberg, Feb. 9, 2009).

[15] See App. 65 (Andrew Ross Sorkin, Lehman Files for Bankruptcy; Merrill Is Sold, N.Y. Times, Sept. 15, 2008).

[16] See App. 66 (David K. Randall, What Happens to Lehman Shares Now, Forbes, Sept. 15, 2008).

[17] See App. 65 (Andrew Ross Sorkin, Lehman Files for Bankruptcy; Merrill Is Sold, N.Y. Times, Sept. 15, 2008).

[18] See App. 67 (David S. Hilzenrath and Glenn Kessler, U.S. Seizes Control of AIG With $85 Billion Emergency Loan, Wash. Post, Sept. 17, 2008).

[19] See App. 70 (Bill Virgin, WaMu Stock Rises -- Closes at 8 Cents a Share, Seattle P.I., Sept. 30, 2008).

Wachovia.[20]

Nevertheless, most market participants, and market regulators, did not anticipate the effect of the subprime mortgage crisis on the broader economy or the ultimate extent of what we now know, in hindsight, to be the onset of a market collapse. For example:

- In October 2008, Former Chairman of the Federal Reserve Alan Greenspan stated that "***[w]e are in the midst of a once in a century credit tsunami***. . . . The crisis . . . has turned out to be much broader than anything I could have imagined." App. 71 at 15 (The Financial Crisis and the Role of Federal Regulators: Hearing Before the H. Comm. on Oversight & Gov't Reform, 110th Cong. 15 (Oct. 23, 2008) (statement of Dr. Alan Greenspan, Former Chairman of the Federal Reserve)) (emphasis added). "[I]f you go back and ask yourself how in the early years anybody could realistically make a judgment as to what was ultimately going to happen to subprime, ***I think you are asking more than anybody is capable of judging***." Id. at 101-02 (emphasis added).

- In November 2008, Treasury Secretary Henry Paulson stated: "***We have not in our lifetime dealt with a financial crisis of this severity and unpredictability***." App. 73 at 1 (Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and of Gov't Lending and Ins. Facilities: Hearing Before the H. Comm. on Fin. Servs., 110th Cong. 2 (Nov. 18, 2008) (statement of Henry M. Paulson, Jr.) (emphasis added).

- In November 2008, Former Chairman of the SEC David Ruder stated that "***[o]ne key aspect of the credit crisis was the failure of both market participants and regulators to predict the collapse*** of the home loan mortgage market. None of the primary market participants predicted the collapse. The risk management systems of most banks, investment banks, ratings agencies, and credit default swap insurers did not predict the collapse. ***Regulators, including the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Department of Treasury, the SEC, and the Commodity Futures Trading Commission did not predict the collapse***." App. 72 at 4 (Turmoil in the Financial Markets: Hearing Before the H. Comm. on Oversight & Gov't Reform, 110th Cong. 4 (Nov. 13, 2008) (statement of David S. Ruder)) (emphasis added).

Indeed, economists worldwide routinely describe the recent economic downturn by reference to the harshest economic event in the last century, the Great Depression.[21]

Throughout 2007 And 2008, Freddie Mac Repeatedly Disclosed The Amount Of Its Capital Base, Its Minimum Capital Requirements, And The Risk That Its Capital Base May Decline Below Required Levels

Freddie Mac repeatedly and accurately disclosed its core capital position to investors and the specific amount by which its core capital exceeded OFHEO's thirty-percent minimum target capital surplus. The following chart details Freddie Mac's reported core capital per quarter.[22]

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[20] See App. 69 (Eric Dash and Andrew Ross Sorkin, Citigroup Buys Bank Operations of Wachovia, N.Y. Times, Sept. 30, 2008).

[21] See App. 78 at 9 (Int'l Monetary Fund, World Economic Outlook: Crisis and Recovery, April 2009).

[22] See App. 3 at 2, 11 (Supp. to Information Statement dated Mar. 23, 2007 (June 14, 2007)); App. 4 at 2, 11 (Supp. to Information Statement dated Mar. 23, 2007 (Aug. 30, 2007)); App. 5 at 2, 12 (Supp. to Information

Quarter	Reported Regulatory Core Capital (in millions)	Reported Minimum Capital Requirement (in millions)	Reported Regulatory Minimum Capital Surplus (in millions)	Amount Over Regulatory Capital Requirement
Q1 2007	$35,503	$26,112	$9,391	$1.6 billion
Q2 2007	$35,573	$26,355	$9,218	$1.3 billion
Q3 2007	$34,672	$26,001	$8,671	$0.9 billion
Q4 2007	$37,867	$26,473	$11,394	$3.5 billion
Q1 2008	$38,320	$26,937	$11,383	$6.0 billion
Q2 2008	$37,128	$28,710	$8,418	$2.7 billion

In its April 2008 report to Congress, Freddie Mac's regulator, the Office of Federal Housing Enterprise Oversight ("OFHEO"), found that **Freddie Mac was adequately capitalized for all four quarters of 2007:**

> OFHEO classified Freddie Mac as **adequately capitalized for year-end 2006 and all four quarters of 2007**. Since the year-end 2006 classification, **Freddie Mac's capital classification was consistent with publicly released financial statements by the Enterprise** . . . .

App. 57 at 51 (OFHEO Report 2008 to Congress (Apr. 15, 2008)) (emphasis added). As OFHEO noted, Freddie Mac's regulatory core capital levels during the class period were: (1) above OFHEO's minimum regulatory capital requirement during the class period; (2) consistent with Freddie Mac's public disclosures; and (3) accurately disclosed to investors through certified financial statements during the class period. Id. Indeed, as the U.S. District Court for the Eastern District of Virginia recently stated:

> In general, OFHEO's reports about Freddie Mac were positive; as recently as July 2008, OFHEO's director described Freddie Mac and Fannie Mae as "adequately capitalized."

In re Freddie Mac Deriv. Litig., No. 08-0073, slip op. at 2 (E.D. Va. July 27, 2009) (quoting Fannie, Freddie Adequately Capitalized: Lockhart, CNBC.com, July 8, 2008 (App. 61)).

Freddie Mac Announced Losses Throughout The Class Period, And Ultimately The Federal Government Imposed A Conservatorship

The global financial crisis continued to worsen in 2008, leading Freddie Mac, along with

Statement dated Mar. 23, 2007 (Nov. 20, 2007)); App. 8 at 5, 24-25 (Supp. to Information Statement dated Feb. 28, 2008 (Feb. 28, 2008)); App. 10 at 8, 108 (Form 10-Q for Period Ended June 30, 2008).

nearly every other major financial institution, to announce further losses throughout the year. It is common knowledge that 2008 was the worst year economically since the Great Depression, and it culminated in, among other catastrophic financial events, the bankruptcy or government bailout of some of the largest financial institutions and corporations in the world, including Bear Stearns, Lehman Brothers, AIG, Citigroup, and General Motors.

In the midst of Q3 2008, OFHEO's successor, the Federal Housing Finance Agency ("FHFA"), after consultation with the Secretary of the Treasury and the Chairman of the Board of Governors of the Federal Reserve System, decided to impose a conservatorship on Freddie Mac and Fannie Mae. AC ¶¶ 13, 253, 299; App. 64 (Statement of FHFA Director James B. Lockhart, Sept. 7, 2008). Nothing in FHFA's statement on September 7, 2008, explaining the reasons for its decision to place Freddie Mac in conservatorship, reveals any "new" information concerning Freddie Mac's financial condition or suggests that the Company had previously misrepresented or concealed its financial condition. Indeed, FHFA stated that it made its decision because "house prices, earnings and capital have continued to deteriorate" and because "the capacity of [Freddie Mac's and Fannie Mae's] capital to absorb further losses while supporting new business activity is in doubt." App. 64 at 2. FHFA further explained that "market conditions have overwhelmed" the "good progress [that had been made] in many areas" regarding Freddie Mac's "accounting, systems, controls and risk management." Id. at 2, 4 ("Since then credit conditions in the mortgage market continued to deteriorate, with home prices continuing to decline and mortgage delinquency rates reaching alarming levels.").

ARGUMENT

I. PLAINTIFF FAILS ADEQUATELY TO PLEAD LOSS CAUSATION.

As the Supreme Court has held, it is not sufficient that a Plaintiff assert that an alleged misstatement or omission resulted in an artificially inflated stock price, but a Plaintiff must also allege that the purportedly concealed facts have become "generally known" and that, as a result of such disclosure, the defendant company's share price depreciated. Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 344 (2005). Here, Plaintiff routinely fails even to plead that statements

inflated Freddie Mac's stock price, let alone that any concealed facts became known, causing investor losses. Moreover, Plaintiff fails to exclude the far more plausible explanations for its losses, which followed the collapse of the residential mortgage market and the government-imposed conservatorship. Given this larger context, and Plaintiff's failure to allege that the revelation of any alleged fraud caused its losses, Plaintiff's Amended Complaint should be dismissed on the ground that it has failed to plead loss causation.

A. Plaintiff Must Allege That The Disclosure Of The Alleged Fraud, Rather Than Marketwide Phenomena, Was The Cause Of Investor Losses.

To establish its securities fraud claim, Plaintiff must allege loss causation with particularity under Rule 9(b). In re First Union Corp. Sec. Litig., No. 99-237, 2006 WL 163616, at *5-6 (W.D.N.C. Jan. 20, 2006). Even if the less rigorous standard of Rule 8 applied to its loss causation allegations -- and it does not -- Plaintiff nonetheless has failed to state a claim for relief. Under Rule 12, a complaint must contain more than "labels and conclusions," and "[f]actual allegations must be enough to raise a right to relief above the speculative level." Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 555 (2007). A plaintiff's complaint must be "plausible" and "possess enough heft to sho[w] that the pleader is entitled to relief." Id. at 555, 556-57. Determining whether a complaint states a claim for relief is "a context-specific task that requires the reviewing court to draw on its judicial experience and common sense," Ashcroft v. Iqbal, 129 S. Ct. 1937, 1950 (2009), and a complaint should be dismissed where the plaintiff's allegations fail to exclude "more likely explanations" than those alleged in the complaint. Id. at 1951. Here, Plaintiff fails to meet even that more lenient pleading standard.

To plead loss causation adequately, "a plaintiff must allege . . . that the **subject** of the fraudulent statement or omission was the cause of the actual loss suffered, i.e., that the misstatement or omission concealed something from the market that, **when disclosed**, negatively affected the value of the security." Lentell, 396 F.3d at 174 (emphasis added). Plaintiff must allege that a "concealed risk [led] to a decline in stock price either because a corrective disclosure reveal[ed] the falsity of the misrepresentations or omissions or because the risk which

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was concealed materializes and cause[d] the price decline." Leykin v. AT&T Corp., 423 F. Supp. 2d 229, 240 (S.D.N.Y. 2006) (citations omitted).

Merely alleging a drop in stock price following the disclosure of bad news does not suffice. See Leykin, 423 F. Supp. 2d at 240; see also Weiss v. Amkor Tech., Inc., 527 F. Supp. 2d 938, 947 (D. Ariz. 2007) (dismissing claims where alleged corrective press release did "not signal, much less state . . . that prior financial statements were incorrect in any way"); In re Tellium, Inc. Sec. Litig., No. 02-5878, 2005 WL 2090254, at *4 (D.N.J. Aug. 26, 2005) ("Dura itself makes clear that loss causation is not pled upon allegations of drops in stock price following an announcement of bad news that does not disclose the fraud."). Rather, Plaintiff must **specifically** allege how the alleged disclosure revealed the alleged fraud and caused Plaintiff's losses. See In re IPO Sec. Litig., 399 F. Supp. 2d 298, 309 (S.D.N.Y. 2005) ("Lentell imposes a heavy burden on plaintiffs to plead their losses specifically.").

Allegations that do not sufficiently allege that the purported corrective disclosure or event actually revealed the alleged fraudulent scheme or prior misrepresentation are subject to dismissal. See, e.g., Lentell, 396 F.3d at 175 & n.4 (holding that stock price drop following downgrade of stock did not amount to corrective disclosure because downgrades did not reveal to market the falsity of the prior recommendations); In re IPO Sec. Litig., 399 F. Supp. 2d 261, 266 (S.D.N.Y. 2005) (holding that failure to meet earnings forecasts does not have a corrective effect because it does not "disclose the scheme" and therefore "cannot correct the artificial inflation caused by the scheme."); see also Metzler Inv. GMBH v. Corinthian Colleges, Inc., 540 F.3d 1049, 1063 (9th Cir. 2008) ("The [complaint] does not allege that the June 24 and August 2 announcements disclosed -- or even suggested -- to the market that Corinthian was manipulating student enrollment figures company-wide in order to procure excess federal funding, which is the fraudulent activity that Metzler contends forced down the stock that caused its losses.").

Moreover, as the Second Circuit has observed, "when the plaintiff's loss coincides with a marketwide phenomenon causing comparable losses to other investors, the prospect that the plaintiff's loss was caused by the fraud decreases," and the complaint must be dismissed unless it

alleges "facts which, if proven, would show that its loss was caused by the alleged misstatements **as opposed to intervening events**." Lentell, 396 F.3d at 174 (citing First Nationwide Bank v. Gelt Funding Corp., 27 F. 3d 763, 772 (2d Cir. 1994)) (emphasis added). Courts dismiss claims for failure to allege facts that permit the court to determine that an alleged fraud, rather than market conditions, caused the stock decline. See Leykin, 423 F. Supp. 2d at 246 (dismissing complaint that did "not allege facts showing that it was the claimed concealment which caused plaintiffs' losses, rather than the market-wide Internet stock collapse -- nor any way to separate the effect of the misstatements (if there was any) from the general collapse or other causes."); In re The Warnaco Group, Inc. Sec. Litig. (II), 388 F. Supp. 2d 307, 318 (S.D.N.Y. 2005) (dismissing complaint that "contain[ed] no allegations relating to the apportionment of plaintiffs' losses between the disclosed and concealed portions of the risk that materialized").

Two courts recently have dismissed securities fraud claims for failure to plead loss causation in the context of the prevailing deterioration of the mortgage and credit markets. In In re Downey Securities Litigation, the court granted a motion to dismiss, with prejudice, where plaintiff alleged that misrepresentations by management, rather than "the current economic climate," were responsible for the decline in Downey's stock price. 2009 WL 2767670, at *1 (C.D. Cal. Aug. 21, 2009). The court held that the plaintiff failed to plead loss causation where the complaint alleged disclosures that "at best, demonstrate only that the market learned of and reacted to Downey's poor financial health rather than any alleged fraud." Id. at *15 (citation and internal quotation marks omitted). The court further held that plaintiff insufficiently pled loss causation where it merely recited stock price declines "without identifying any corrective disclosures that drove the stock price down" and conclusorily asserted that "stock price declines following various public filings 'remov[ed] some of the artificial inflation from the stock price as some of the relevant truth . . . began to leak out.'" Id. (quoting complaint). Similarly, in In re The First Marblehead Corp. Sec. Litig., the court dismissed the complaint on loss causation grounds. There, the court held that defendant's actual disclosures, coupled with "the deterioration in the credit markets" and a "preexisting pattern of stock declines negate Lead

Plaintiff's theory of loss causation." 2009 WL 2386463, at *13 (D. Mass. Aug. 5, 2009).

B. Plaintiff Fails To Assert That The Disclosure Of The Alleged Fraud, Rather Than Marketwide Phenomena, Was The Cause Of Its Losses.

Plaintiff's loss causation allegations suffer from fatal defects. Plaintiff fails sufficiently to plead that any fraud actually caused any losses or any facts that exclude the more plausible explanation that losses resulted from marketwide forces and the imposition of a conservatorship.

1. Plaintiff Fails Sufficiently To Plead That Its Losses Were Caused By Any Fraud.

As the Supreme Court has held, merely alleging that a fraudulent statement resulted in the inflation of a purchase price is insufficient. Dura, 544 U.S. at 345-46. A securities plaintiff must further allege that the inflation came out of the stock price when the truth became generally known. Id. at 342-43. Notably, here, the allegedly false statements were followed by declines, and not any inflation, in Freddie Mac's stock price. See, e.g., ¶¶ 450, 455, 464, 484, 487, 517, 520. Plaintiff's explanation for this highly unusual phenomenon -- i.e., fraudulent statements causing stock price deflation -- is the repeated assertion that the price would have fallen further but for the challenged statements. See, e.g., ¶¶ 450, 455, 464, 484, 487, 517, 520. That assertion is the sort of bare conclusion, devoid of any factual heft excluding more likely explanations, that cannot survive under Twombly and Iqbal. See supra Part I.A.

Further, an examination of Plaintiff's allegations respecting each supposedly corrective disclosure reveals that each alleged corrective disclosure is no such thing. For example, referring to a Wall Street Journal article published on July 3, 2008, Plaintiff alleges that "[b]eginning on July 3, 2008, a flurry of news began to partially reveal the true financial picture at Freddie Mac" and that "[i]n response to this partial revelation . . . the trading price of Freddie Mac common stock declined 8.9%." AC ¶ 523. The WSJ article, however, does nothing more than discuss facts that were already publicly available; namely, that the Company had not accomplished the capital-raising plans it had announced in May, and that the stock had "tumbled more than 40% since May 14, when it announced the Company's capital raising plans." Further, the author opined that "the longer Freddie waits, the more shares it might have to issue, causing more pain

for existing shareholders." App. 60 (Peter Eavis, A Delay-of-Pain Penalty -- Freddie Mac Falls as Stock Issue Stalls, Wall St. J., July 3, 2008). The article also discussed the already public fact that the Company was not an SEC registrant. Id. at 2. Recharacterizations of these known facts cannot constitute a corrective disclosure. See In re Omnicom Group, Inc. Sec. Litig., 541 F. Supp. 2d 546, 552 (S.D.N.Y. 2008) ("A recharacterization of previously disclosed facts cannot qualify as a corrective disclosure."). Likewise, none of the other supposedly corrective disclosures at that time revealed any supposed fraud. See AC ¶¶ 523(c)-(d).

By way of further example, Plaintiff cites a number of other disclosures, including an announcement by Treasury Secretary Paulson, that the federal government would take certain actions to provide liquidity to Freddie Mac. AC ¶¶ 529, 531, 533, 535. The Amended Complaint does not, and cannot, allege that Mr. Paulson's announcement or related news articles were somehow corrective disclosures. Nothing said by Secretary Paulson suggests that Freddie Mac had ever misrepresented any facts regarding its capital adequacy or its exposure to mortgage-related losses. His announcement simply does not refer to these topics.[23] Furthermore, the mere fact that Mr. Paulson decided to come forward with the announcement of a plan cannot establish any corrective disclosure. Freddie Mac, certainly, had no control over the Administration, had never presumed to predict what the Administration would do, and is not alleged to have done so. Accordingly, it cannot have concealed a risk that the Administration would decide to take or not to take any actions with respect to Freddie Mac.

Although Plaintiff is required to allege that alleged corrective disclosures caused stock price **declines**, Plaintiff actually points to a number of allegedly corrective disclosures that were followed by stock price **increases**. For example, the Amended Complaint alleges in completely conclusory fashion that "a litany of news articles" published on July 14 and 15, 2008, following the Paulson announcement, "shed[] additional light on the Company's true financial

[23] See Metzler, 540 F.3d at 1063 ("The TAC does not allege that the June 24 and August 2 announcements disclosed -- or even suggested -- to the market that Corinthian was manipulating student enrollment figures company-wide in order to procure excess federal funding, which is the fraudulent activity that Metzler contends forced down the stock that caused its losses.").

circumstances[.]" AC ¶ 531. Plaintiff's reliance on these articles is badly misplaced. Freddie Mac's stock price rose between July 15 and July 23, from $4.68 to $10.80. Accordingly, even if these statements were corrective disclosures -- and they were not -- they could not have caused any losses. See In re Maxim Integ. Prods., Inc. Sec. Litig., --- F. Supp. 2d ---, 2009 WL 2136939, at *6 (N.D. Cal. July 16, 2009) (rejecting loss causation allegations where stock price increased day following disclosure); see also In re Buca Inc. Sec. Litig., No. 05-1762, 2006 WL 3030886, at *9 (D. Minn. Oct. 16, 2006) (holding that a one-day drop in stock price following alleged corrective disclosure was insufficient where price increased the following week).[24]

Plaintiff's ultimate loss causation allegation is that, "with stunning finality, Defendants' fraud was completely revealed to the market" on September 7, 2008, when Fannie Mae and Freddie Mac agreed to the Administration's rescue plan. AC ¶¶ 563-64; see supra pp. 3-4. Plaintiff simply does not allege how this event revealed any fraud. The disclosure of a fraud is certainly not established by the bare fact that the Director of FHFA placed the GSEs in conservatorship. See, e.g., Leykin, 423 F. Supp. 2d at 245 ("As dire as those statements were, and as grave as the Promethean Financing and bankruptcy filing turned out to be, nothing in those statements disclosed that the alleged misrepresentations had been false or misleading."). Nor was this a "materialization of a concealed risk." There are no allegations in the Amended Complaint that Freddie Mac misrepresented or concealed a possibility that the government would impose a conservatorship, or that Freddie Mac could accurately predict what the government would do.

Furthermore, nothing in FHFA's own statement on September 7 explaining the reasons for its decision to place Freddie Mac in conservatorship -- which Plaintiff has elected not to cite -- suggests that the Company had previously misrepresented or concealed anything. App. 64

[24] Freddie Mac's stock also increased on each of the four trading days following the alleged corrective disclosures on August 22, from $2.81 on August 22 to $5.28 on August 28, 2008. Accordingly, as a matter of law, the disclosures on August 20 through 22 could not have caused Plaintiff's loss. See, e.g., Buca, 2006 WL 3030886, at *9 (dismissing complaint; holding that loss causation allegations were insufficient where "the share price was trending downward throughout the Class Period" and rose in the days following the alleged disclosure).

(Statement of FHFA Director James B. Lockhart, Sept. 7, 2008). Indeed, FHFA's stated rationale for its action was that "house prices, earnings and capital have continued to deteriorate" -- and that "the capacity of [the GSEs'] capital to absorb further losses while supporting new business activity is in doubt." App. 64 at 2. FHFA further explained that "market conditions have overwhelmed" the "good progress [that had been made] in many areas" regarding Freddie Mac's "accounting, systems, controls and risk management." Id. In short, no fraud was revealed.

Having failed to identify any fraud that, when disclosed, caused Plaintiff's losses, Plaintiff's claims should be dismissed for failure sufficiently to allege loss causation.

2. Plaintiff Fails Sufficiently To Plead Any Facts That Would Exclude More Likely Explanations For Investor Losses.

Plaintiff's claims also should be dismissed because Plaintiff fails to exclude "more likely explanations" for Freddie Mac's stock price decline. Iqbal, 129 S. Ct. at 1951. As discussed above, under Lentell, "when the plaintiff's loss coincides with a marketwide phenomenon causing comparable losses to other investors, the prospect that the plaintiff's loss was caused by the fraud decreases," and the complaint must be dismissed unless it alleges "facts, which, if proven, would show that its loss was caused by the alleged misstatements **as opposed to intervening events**." 396 F.3d at 174 (emphasis added). Plaintiff alleges no such facts.

Indeed, Plaintiff's allegations simply ignore that Freddie Mac's stock price had fallen by 40% during the class period, prior to the first purported corrective disclosure, which Plaintiff alleges was on July 3, 2008. See Merrill Lynch, 568 F. Supp. 2d at 364 (dismissing complaint for failure to plead loss causation where complaint failed "to explain how the decline of the stock price . . . was attributable to the alleged fraud, rather than simply a continuation of the loss in value that afflicted CMGI during the Internet sector's collapse.").[25]

[25] See also 60223 Trust v. Goldman, Sachs & Co., 540 F. Supp. 2d 449, 461 (S.D.N.Y. 2007) ("The complaint does not even refer to the phenomenon of the gradual loss of the stock's value, much less attempt to explain it as related to loss causation."); In re Rhodia S.A. Sec. Litig., 531 F. Supp. 2d 527, 547 (S.D.N.Y. 2007) ("The allegations in the Complaint describe a slow, steady decline which, importantly, Defendants never actually hid from the public. . . . Where there are warnings about the steady decline of a publicly owned company, its shareholders cannot innocently claim ignorance about the true status of the company's financial health.").

Also telling is the performance of the stock of Freddie Mac's largest competitor, Fannie Mae. As reflected in articles cited throughout the Amended Complaint, such as the March 2008 Barron's article, Fannie Mae and Freddie Mac were similarly situated GSEs exposed to the housing downturn. App. 55 (Jonathan R. Laing, The Next Gov't Bailout?, Barron's, Mar. 10, 2008). The "bailout" of Freddie Mac, said by Plaintiff to have "revealed" Defendants' "fraud," was accompanied contemporaneously by the "bailout" of Fannie Mae. The stock price of both GSEs moved in tandem during the nationwide housing crisis. See Chart, supra p. 5. This makes it particularly implausible that the decline in Freddie Mac's share price was attributable to fraud as opposed to the economic forces buffeting both Freddie Mac and Fannie Mae. Cf. In re Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493, 513 (S.D.N.Y. 2009) ("If there was such a downturn, one would expect the stock prices for Moody's competitors to fall along with that of Moody's.").

In sum, Plaintiff simply ignores the worst housing crisis since the Great Depression and conclusorily attributes the decline in Freddie Mac's stock price to fraud. Because Plaintiff has failed to allege "(i) facts sufficient to support an inference that it was defendant's fraud -- rather than other salient factors that proximately caused plaintiff's loss; or (ii) facts sufficient to apportion the losses between the disclosed and concealed portions of the risk that ultimately destroyed an investment," its complaint should be dismissed. Merrill Lynch, 568 F. Supp. 2d at 363 (citing Lentell, 396 F.3d at 174).

II. THE AMENDED COMPLAINT SHOULD BE DISMISSED UNDER THE PSLRA AND RULE 9(b).

The PSLRA's pleading requirements are strict and rigorous, requiring Plaintiff to "specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading." ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co., 553 F.3d 187, 196 (2d Cir. 2009). The PSLRA further requires Plaintiff to state with particularity "facts giving rise to a strong inference" of scienter. Id. Similarly, Rule 9(b)

requires Plaintiff to state "with particularity" the circumstances constituting the alleged fraud.

As discussed below, the Amended Complaint fails: (1) to plead a single alleged misrepresentation or omission with the requisite particularity; and (2) to plead specific facts giving rise to a strong inference of scienter.

A. The Alleged Misrepresentations And Omissions Are Not Pled With The Particularity Required By The PSLRA And Rule 9(b).

1. The Amended Complaint Fails Adequately To Plead A Single False Statement Or Omission Of Material Fact.

As this Court has explained, "[v]olumes of indiscriminate and conclusory allegations do not substitute for the specificity the law requires." Kemp v. Universal Am. Fin. Corp., No. 05-9883, 2007 WL 86942, at *17 (S.D.N.Y. Jan. 10, 2007) (Keenan, J.).[26] Although Plaintiff litters the AC with a multiplicity of alleged negative facts about Freddie Mac's business, the AC is devoid of any specific facts establishing that any statement was false when made, let alone that any Defendant knew that any statement was false.

Instead of adhering to the exacting pleading standards of the PSLRA and Rule 9(b), the Amended Complaint's structure seems designed to confuse and obscure. Plaintiff does not even begin to set forth the challenged statements until page 121 of its AC. Thereafter, Plaintiff includes in its Amended Complaint lengthy block quotes of alleged misstatements (while using selective omissions to distort what Defendants actually said). See, e.g., AC ¶¶ 441-49, 489-92. Then, purporting to explain how these statements were allegedly false or misleading, Plaintiff simply refers to long lists of single-spaced bullet points, and "arrows" within bullet points, without relating these items to specific statements at issue. See, e.g., ¶¶ 452, 465. Plaintiff does not provide any specific connection between these items and the challenged statements.

For this reason alone, the Eighth Circuit recently affirmed the dismissal, with prejudice, of similarly defective allegations arising out of the collapse of the home mortgage market. See

[26] See also Williams v. WMX Techs., Inc., 112 F.3d 175, 178 (5th Cir. 1997), cert. denied, 522 U.S. 966 (1997) ("A complaint can be long-winded, even prolix, without pleading fraud with particularity. Indeed, such a garrulous style is not an uncommon mask for an absence of detail."); New York State Teachers' Ret. Sys. v. Fremont Gen. Corp., No. 07-05756, 2008 WL 4812021, at *4-7 (C.D. Cal. Oct. 28, 2008) (dismissing 175-page complaint where plaintiff failed to link specific statements with reasons they were misleading).

In re 2007 Novastar Fin., Inc., Sec. Litig., --- F.3d ---, 2009 WL 2747281 (8th Cir. Sept. 1, 2009). In Novastar, the Eighth Circuit described as follows the securities class action complaint filed against a subprime mortgage lender:

> The complaint began by describing the alleged deterioration of [the company's] underwriting standards and auditing processes and the alleged increasing number of loan defaults during the class period, drawing on information from former [company] employees . . . . Next . . . the complaint reproduced, either in their entirety or lengthy excerpts from . . . press releases, SEC filings, and conference call transcripts . . . issued by [the company] and the individual defendants during the class period that were allegedly false or misleading.

Id. at *1 (internal citations omitted).

In affirming the dismissal of plaintiffs' claims, the Eighth Circuit explained:

> Absent from [the complaint] . . . is any indication as to what specific statements within these communications are alleged to be false or misleading. . . . Even if we were able to identify specific statements that were alleged to be misleading, we would still conclude that [the plaintiffs'] complaint failed to specify the reasons why each statement was false or misleading. **The complaint does not provide any link between an alleged misleading statement and specific factual allegations demonstrating the reasons why the statement was false or misleading, as the PSLRA requires**.

Id. at *3-4 (citation omitted) (emphasis added).[27]

The Amended Complaint here employs the very same defective pleading approach as the one in Novastar. It fails to identify what specific statements -- within the numerous communications it quotes -- are supposedly false, let alone why. Instead, Plaintiff impermissibly imposes on the Court the burden of divining which specific statements are allegedly false and then matching them up with allegations of wrongdoing scattered through the 290-page Amended Complaint.[28]

For example, in Paragraph 441, Plaintiff simply inserts a lengthy block quote spanning

[27] See also Downey, 2009 WL 2767670, at *3 (dismissing, with prejudice, 504-paragraph complaint that "placed the burden on the reader to sort out the statements and match them with the corresponding adverse facts to solve the 'puzzle' of interpreting Plaintiff's claims") (quotations omitted).

[28] In re Goodyear Tire & Rubber Co. Sec. Litig., 436 F. Supp. 2d 873, 904 (N.D. Ohio 2006) (a securities fraud plaintiff may not evade his pleading requirements by "requiring the Court to try to match the allegedly fraudulent statements to the allegations of wrongdoing that are scattered throughout the seventy-plus page Amended Complaint").

well over a page, omits key disclosures from the quote, bolds and italicizes certain statements within the block quote, and then leaves it to the Court and Defendants to figure out which particular quoted statements are allegedly false or misleading, and why. See AC ¶ 441. Although Plaintiff bolds a collection of statements for apparent emphasis, nowhere does Plaintiff allege how or why any statement made was false or misleading.

Likewise, Plaintiff uses nearly five pages of its AC to quote from Freddie Mac's March 12, 2008 investor conference. See AC ¶ 352. Nowhere does Plaintiff directly take issue with the specific figures advanced in that presentation. Instead, Plaintiff rests on conclusory allegations that the statements were "materially false and misleading" because the value of Freddie Mac's investments "were in freefall." AC ¶ 355. But Plaintiff makes no connection between its allegations and any specific statement made in that pages-long excerpt. This lack of specificity is fatal to Plaintiff's claims. See supra Part II.A.1.

Moreover, where Plaintiff does cite figures, its numbers are inscrutable. For example, Plaintiff says Freddie Mac's exposure to "subprime, Alt-A, and other default prone loans and securities" was $628.5 billion. AC ¶ 164. It then quotes some economists as calculating the exposure at $392 billion. AC ¶ 166. It then conclusorily asserts that its own calculations amount to $640 billion. AC ¶ 167. These different figures are from just one page of the AC. Again and again Plaintiff trots out unsupported and inconsistent numbers in an effort to conjure a false specter of fraud from the confusion Plaintiff itself has created. The AC is, however, consistent in its repeated failure to allege specific facts explaining how any statement cited in the AC was false when made. See infra Part III.C & App. 44 (a statement-by-statement analysis detailing how Plaintiff fails to allege any actionable statement).[29]

Plaintiff has thus failed adequately to plead with particularity a single misstatement of material fact. Thus, as in Novastar, the Plaintiff's claims fail for that reason alone.

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[29] Plaintiff's "confidential witness" allegations do not cure this pleading defect. See AC ¶¶ 36-62. Not one alleged fact that Plaintiff attributes to any of its confidential witnesses contradicts any challenged statement purportedly made by any Individual Defendant. See infra Part III.A.1 (explaining "misleadingly incomplete" jurisprudence).

2. Plaintiff Fails To Plead A Violation Of GAAP.

A prime example of Plaintiff's deficient approach to pleading securities fraud is its effort to assert that Defendants misrepresented the adequacy of Freddie Mac's core capital, based on allegations of accounting violations. AC ¶¶ 352-440. Plaintiff's conclusory allegations fail to include any specific facts showing that Freddie Mac violated a single provision of Generally Accepted Accounting Principles ("GAAP"). Conclusory allegations of GAAP violations do not suffice. Caiafa v. Sea Containers Ltd., No. 08-3006, 2009 WL 1383457, at *1 (2d Cir. May 19, 2009) (affirming dismissal where plaintiffs' "cursory" GAAP allegations "establish neither defendants' motive and opportunity nor strong circumstantial evidence of conscious behavior or recklessness."); JP Morgan Chase Co., 553 F.3d at 198-99 (affirming dismissal where allegations of GAAP violations were not coupled with sufficient evidence of fraudulent intent). Courts routinely dismiss securities fraud complaints that fail to plead specific facts showing that the GAAP provision in question has been triggered and violated. See, e.g., Greebel v. FTP Software, Inc., 194 F.3d 185, 203-04 (1st Cir. 1999) (affirming dismissal where plaintiffs failed to plead specific facts indicating violation of FAS 48); In re K-Tel Int'l, Inc. Sec. Litig., 300 F.3d 881, 891-93 (8th Cir. 2002) (affirming dismissal where plaintiffs failed to plead specific facts indicating that defendants violated FAS 121 or FAS 5). Here, Plaintiff fails to plead any specific facts demonstrating that Freddie Mac committed any GAAP violation.

a. Plaintiff Fails Adequately To Allege A Violation Of FAS 115.

Plaintiff alleges that Freddie Mac violated Statement of Financial Accounting Standards No. 115 ("FAS 115") by failing timely to record "an other-than-temporary impairment in the value of Freddie Mac's investments that it classified as AFS securities in its financial statements." AC ¶ 359. Plaintiff distorts the applicable accounting standard and fails to support its contention with specific facts.

Under FAS 115, a security classified as "available-for-sale" should be considered other-than-temporarily impaired when a decline in the security's fair value below its amortized cost basis is other than temporary, i.e., when "it is probable that the investor will be unable to collect

all amounts due **according to the contractual terms** of a debt security." App. 81 ¶ 16 (FAS 115) (emphasis added). GAAP defines "probable" as "likely to occur." App. 79 ¶ 3 (FAS 5). Accordingly, FAS 115 necessarily requires a company to make subjective determinations concerning whether it is "probable" that the company will not collect all contractual cash flows. Courts are loath to substitute their own judgment for that of an issuer on highly subjective accounting decisions, such as the determination of when the value of an asset should be written down, due to the inherent subjectivity of such a determination. See, e.g., In re Galileo Corp. S'holders Litig., 127 F. Supp. 2d 251, 265-66 (D. Mass. 2001). Indeed, due to the subjective nature of the decision to write down an asset, a plaintiff must point to specific facts, such as inconsistent contemporaneous statements or internal reports, showing that the company knew it was required to take a write-down and failed to do so. In re Capstead Mortgage Corp. Sec. Litig., 258 F. Supp. 2d 533, 550 (N.D. Tex. 2003).

Here, as in Galileo and Capstead, Plaintiff fails to provide the Court with specific facts to support its allegation that Freddie Mac violated GAAP by failing to make the subjective determination to write down its securities. Rather, Plaintiff stiches together a patchwork of conclusory allegations that fail to establish a violation of FAS 115. According to Plaintiff, by March 31, 2008, Freddie Mac's subprime and Alt-A securities had become other than temporarily impaired because: (1) Freddie Mac's ABS and Alt-A securities fell below fair value; and (2) default and delinquency rates increased generally on ABS and Alt-A mortgages during the class period. AC ¶¶ 359, 369, 370.

Plaintiff's allegations, however, ignore the specific contractual terms of Freddie Mac's securities. First, as Freddie Mac broadly disclosed, its subprime portfolio consisted of "AAA securities . . . structured with substantial credit enhancements in order to be able to withstand losses even in extremely poor credit environments." AC ¶ 352. Those credit enhancements, i.e., contractual terms, consisted of three prophylactic features: (1) initial subordination (subordinate tranches exist to absorb losses and securities are over-collateralized); (2) excess interest (an amount within the trust that can materially enhance the ability to absorb losses); and

(3) prepayments (prepayments return principal to tranches thereby reducing the risk of principal losses and increasing the percentage of credit enhancement available to cover future losses). Id.; see also App. 82 ¶ 26 (FASB Staff Position No. FAS 115-2) ("[a]n entity also should consider how other credit enhancements affect the expected performance of the security"). Plaintiff, however, fails to plead any specific facts regarding any of these three contractual terms, or to explain why Freddie Mac violated FAS 115 in relying on those credit enhancements when it assessed the probability of collection. See Capstead, 258 F. Supp. 2d at 550.

Second, Plaintiff ignores the rapidly changing economic landscape during the class period. Freddie Mac's determination that its securities were not other-than-temporarily impaired during the quarter ended March 31, 2008 was necessarily "a matter of judgment and estimate" that required Freddie Mac to make a "subjective determination." See Galileo, 127 F. Supp. 2d at 265. That Freddie Mac's "subjective determination" was made prior to the severe economic decline that occurred during the third quarter of 2008 does not equate to a GAAP violation, let alone fraud. Plaintiff's conclusory allegations to the contrary, devoid of necessary specific facts showing inconsistent contemporaneous statements or internal reports, amount to nothing more than allegations of fraud by hindsight, which cannot support a securities fraud claim. See Denny v. Barber, 576 F.2d 465, 470 (2d Cir. 1978) (finding defendant's lack of "clairvoyance" to anticipate economic crisis of the 1970s is "fraud by hindsight," not securities fraud).

b. Plaintiff Fails Adequately To Allege A Violation Of FAS 109.

Plaintiff also alleges, incorrectly, that Freddie Mac violated Statement of Financial Accounting Standards No. 109 ("FAS 109") by failing to establish a valuation allowance for its deferred tax assets by March 31, 2008. AC ¶¶ 430-32. Plaintiff's allegations blatantly ignore both the actual language of FAS 109 and the positive evidence that militated against Freddie Mac's establishing a valuation allowance. See App. 80 (FAS 109).

FAS 109 requires an enterprise to establish a valuation allowance against deferred tax assets when, based upon the weight of available evidence, it is more likely than not that the deferred tax assets will not be realized. App. 80 ¶ 17. The realization of deferred tax assets is

dependent on the existence of future taxable income. Id. ¶ 21. An enterprise should consider "[a]ll available evidence, both positive and negative" in determining whether a sufficient amount of future taxable income will exist to realize the enterprise's deferred tax assets. Id. ¶ 20. As such, FAS 109 directs enterprises to consider "[i]nformation about an enterprise's current financial position and its results of operations for the current and preceding years" as well as all "currently available information about future years." Id. ¶ 20. In particular, FAS 109 notes that "positive," i.e., favorable, evidence militating against the establishment of a valuation allowance can include, inter alia, "**[a] strong earnings history** exclusive of the loss that created the future deductible amount . . . coupled with evidence indicating that the loss (for example, an **unusual**, **infrequent**, or **extraordinary** item) is an **aberration** rather than a continuing condition." Id. ¶ 24 (emphasis added). Ultimately, "[a]n enterprise must use judgment in considering the relative impact of negative and positive evidence." Id. ¶ 25.

Here, Plaintiff disregards FAS 109's directive to weigh both positive and negative information to determine whether a valuation allowance is needed. Instead, Plaintiff focuses entirely on what it perceives as negative information, utterly ignoring the positive information available during the first quarter of 2008. See AC ¶¶ 429-37. For example, Plaintiff ignores Freddie Mac's strong earnings history. See App. 80 ¶ 24 (FAS 109). Freddie Mac generated net income from 2000 through 2006 averaging $4.1 billion annually. See App. 11 (Excerpts from 2000-2006 Freddie Mac Financial Statements). Plaintiff also ignores the fact that Freddie Mac's financial difficulties during the class period resulted from the largest decline in single-home values in recorded history causing "a once in a century credit tsunami" (see supra p. 12), which certainly qualifies as an "unusual, infrequent, or extraordinary item" and "aberration." See App. 80 ¶ 24 (FAS 109). Further, Plaintiff's allegation that Freddie Mac should have created a valuation allowance in March 2008 amounts to nothing more than an allegation of fraud by hindsight. See Denny, 576 F.2d at 470.[30] Put simply, Plaintiff's failure to address the extent of

[30] Plaintiff's allegation that "management would have needed to forecast more profits than Freddie Mac had reported during its prior five years" to realize its deferred tax assets is incorrect. See AC ¶ 436. Under

positive evidence that militated against the creation of a valuation allowance renders fatally deficient its conclusory allegation that Freddie Mac violated FAS 109.

In sum, Plaintiff's failure to plead any allegedly actionable statements with the particularity required by the PSLRA and Rule 9(b) dictates the dismissal of its claims.

B. Plaintiff Fails Adequately To Plead Scienter.

Plaintiff's claims also should be dismissed for the independent reason that it has failed adequately to plead scienter. The PSLRA's "[e]xacting pleading requirements" compel plaintiffs to "state with particularity facts giving rise to a **strong inference** that the defendant acted with the required state of mind." Tellabs, 551 U.S. at 313-14 (quoting 15 U.S.C. § 78u-4(b)(2)) (emphasis added). To be "strong," the inference must be "cogent and **at least as compelling** as any opposing inference one could draw from the facts alleged." Id. at 324 (emphasis added). Plaintiff fails to satisfy this standard.

1. Plaintiff Pleads No Specific Facts Giving Rise To A Strong Inference Of Scienter.

"It is well established that boilerplate allegations that defendants knew or should have known of fraudulent conduct based solely on their board membership or executive positions are insufficient to plead scienter." In re Sotheby's Holdings, Inc. Sec. Litig., No. 00-1041, 2000 WL 1234601, at *7 (S.D.N.Y. Aug. 31, 2000). Securities fraud complaints that fail to **specifically identify** documents or other contemporaneous facts tending to show that the defendants knew the statements in question were false when made are subject to dismissal. See San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 812 (2d Cir. 1996) (affirming dismissal of claim based on alleged existence of confidential company sales reports); Goplen v. 51job, Inc., 453 F. Supp. 2d 759, 768 (S.D.N.Y. 2006) (dismissing claim where "[p]laintiffs fail[ed] to identify any documents, meetings, or reports [showing] that defendants knew" that challenged statements were misleading).

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applicable tax law, Freddie Mac was permitted to look forward **20 years** to determine whether cumulative future income was sufficient to realize its deferred tax assets. See I.R.C. § 172(b).

This Court can pull a fine-tooth comb through the AC and not find **one specific fact** supporting any inference that any Defendant knew that any challenged statement was false. The AC does not refer to one specific document, meeting, conversation or other information supporting **any** inference that **any** Defendant acted with scienter.[31]

2. Plaintiff's Conclusory Allegations Regarding What Defendants Allegedly Knew Do Not Give Rise To A Strong Inference Of Scienter.

Plaintiff's unsubstantiated allegations about what Defendants "must have known" also fail to support a strong inference of scienter. As the Second Circuit has held, courts should give no credence to such conclusory allegations, which by their nature are unsupported by specific facts actually known by defendants. Rather, "[w]here plaintiffs contend defendants had access to contrary facts, they must specifically identify the reports or statements containing this information." Novak v. Kasaks, 216 F.3d 300, 309 (2d Cir. 2000), cert. denied, 531 U.S. 1012 (2000); see also Hart v. Internet Wire, Inc., 145 F. Supp. 2d 360, 368 (S.D.N.Y. 2001) ("[T]o withstand a motion to dismiss plaintiffs must detail specific contemporaneous data or information known to the defendants that was inconsistent with the representation in question.") (citation and quotation marks omitted).

For this reason, Plaintiff gets nowhere with convoluted allegations that the Individual Defendants supposedly received a "risk report" in August 2007 that "identified the various risk indicators used to track the manifestation of the risks and as the basis for triggering responses to the risks." AC ¶¶ 221-28. Plaintiff fails to allege any specific facts regarding any one report that any Defendant allegedly received, such as the date of any report, the specific content of any report, or how any information contained in any report was allegedly inconsistent with any challenged statement. Numerous courts have held such allegations defective as a matter of law.[32]

[31] The only specific internal document Plaintiff identifies is a memorandum allegedly drafted by a former employee, David Andrukonis, in 2004. AC ¶¶ 10, 538. Plaintiff's allegations concerning that 2004 memorandum, however, fail to establish that any statement made during the class period was false when made, let alone knowingly false. Moreover, the allegations relating to the Andrukonis memorandum are at best merely allegations of mismanagement, which are not actionable under the federal securities laws. See infra Part III.A.2.

[32] See, e.g., In re Skechers U.S.A., Inc. Sec. Litig., No. 05-55980, 2008 WL 1721557, at *1 (9th Cir. Apr. 10, 2008) (plaintiffs "failed to meet their burden under the PSLRA" where the complaint "fail[ed] to describe with any detail the contents of [alleged] interim reports, who drafted them, or how the confidential witnesses were in a

3. Plaintiff's Confidential Source Allegations Do Not Support Any Inference Of Scienter.

Plaintiff's "confidential witness" allegations do not cure Plaintiff's pleading defects. AC ¶¶ 35-63. A securities plaintiff may properly cite a confidential source only when alleged facts "provide an adequate basis for believing that the defendants' statements were false." Novak, 216 F.3d at 314. Further, confidential sources must be "described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged." Id.; see also In re American Express Co. Sec. Litig., No. 02-5533, 2008 WL 4501928, at *8 (S.D.N.Y. Sept. 26, 2008) ("Plaintiffs have also failed to allege any facts showing that the confidential sources . . . had any contact with the Individual Defendants or would have knowledge of what they knew or should have known during the Class Period.").

Courts have held that, because of their anonymity, confidential sources are entitled to little weight, especially in light of the Tellabs requirement that any inference of scienter must be at least as compelling as opposing inferences one could draw. See Higginbotham v. Baxter Int'l, 495 F.3d 753, 757 (7th Cir. 2007) (holding, in light of Tellabs, that allegations from confidential witnesses must be discounted, and "[u]sually that discount will be steep," because "[i]t is hard to see how information from anonymous sources could be deemed 'compelling' or how we could take account of plausible opposing inferences. Perhaps these confidential sources have axes to grind. Perhaps they are lying. Perhaps they don't even exist."); Ley v. Visteon Corp., 543 F.3d 801, 811 (6th Cir. 2008) (discounting confidential source allegations); Indiana Elec. Workers' Pension Trust Fund IBEW v. Shaw Group, Inc., 537 F.3d 527, 535 (9th Cir. 2008) (same).

Given the foregoing law, it is not surprising that there is a wealth of authority establishing that confidential witness allegations lack any weight where the alleged witness did not work at the defendant company during the class period,[33] where the alleged witness did not have any

position to know that the defendants received the alleged reports") (emphasis added); Arazie v. Mullane, 2 F.3d 1456, 1467 (7th Cir. 1993) (holding insufficient "scanty descriptions" of internal documents absent facts showing "who sent the memo, when it was received, or whether it reflected a final determination") (emphasis added).

[33] See, e.g., California Pub. Employees' Ret. Sys. v. Chubb Corp., 394 F.3d 126, 149-50, 154 (3d Cir. 2004) (affirming dismissal where plaintiff "fail[ed] to allege when [confidential] sources were employed by the

contact with the defendants such that he or she could testify as to their knowledge,[34] where the alleged witness supports vague, conclusory, or unrelated allegations,[35] or where the witness's statements are based on hearsay or otherwise lack indicia of personal knowledge.[36]

Here, not one of the confidential witnesses is alleged to have had any communications with the Individual Defendants during the class period about any challenged statement. Although Plaintiff proclaims that it conducted "interviews with more than 100 former Freddie Mac employees and others with knowledge of the facts underlying Defendants' fraud[,]" AC ¶ 35, the AC actually cites 27 confidential witnesses, and **only three** of these confidential witnesses were purportedly both employed at Freddie Mac during the class period and claim to have had even attenuated contact with any of the Individual Defendants relating to events during the class period. See AC ¶¶ 36-62.[37] None of the allegations as to these three witnesses gives

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[defendant company]" and plaintiff failed to allege that a certain confidential witness was employed when he or she would know the date of an alleged meeting or whether any defendant was present); Campo v. Sears Holdings Corp., No. 06-4053, 2009 WL 2151289, at *8 (S.D.N.Y. July 21, 2009) (dismissing complaint and rejecting scienter allegations based on two confidential witnesses who departed the company prior to the class period).

[34] See, e.g., Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1250 (11th Cir. 2008) (affirming dismissal with prejudice where confidential witnesses failed to "mention[] any conversation or directive coming from the individual defendants . . . ordering them to commit [the alleged] fraud or instructing them on how to do it"); Downey, 2009 WL 736802, at *13 (finding that statements of thirteen confidential witnesses "lack the requisite specificity" because, inter alia, "[m]any of the statements do not relate to any of the Individual Defendants").

[35] See, e.g., Chubb, 394 F.3d at 155 (affirming dismissal with prejudice where confidential witnesses alleged that certain "true facts" were "well known within [the company]," but the court deemed them "[g]eneric and conclusory allegations based upon rumor or conjecture [and] undisputedly insufficient to satisfy the heightened pleading standard of [the PSLRA]"); In re Elan Corp. Sec. Litig., 543 F. Supp. 2d 187, 220 (S.D.N.Y. 2008) (dismissing complaint because allegations regarding confidential witnesses, including that they were "intimately involved" and "directly involved" in relevant events, were "far too vague with respect to what information was actually communicated and what conclusions any defendant actually reached").

[36] See Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981, 996 (9th Cir. 2009) ("Although the SAC describes the confidential witnesses' job titles and employment information with ample detail . . . we conclude that the SAC fails to allege with particularity facts supporting its assumptions that the confidential witnesses were in a position to be personally knowledgeable of the information alleged."); Cornelia I. Crowell GST Trust v. Possis Med., Inc., 519 F.3d 778, 782 (8th Cir. 2008) (allegations lacked the detail necessary where plaintiff "d[id] not even allege facts which demonstrate how the anonymous [company] employees had gained access to [the alleged] information"); Malin v. XL Capital Ltd., 499 F. Supp. 2d 117, 139 n.17 (D. Conn. 2007) (dismissing claims and refusing to credit confidential witness allegations based on hearsay), aff'd, 2009 WL 481897 (2d Cir. Feb. 26, 2009).

[37] More specifically, nine of Plaintiff's confidential witnesses are not even alleged to have been employed by Freddie Mac during the class period, see AC ¶¶ 36, 38, 46, 53, 55, 56, 57, 59, 61, and four other confidential witnesses were not even employed by Freddie Mac, but were employed by OFHEO or companies that provided consulting services to Freddie Mac, where they purportedly gained generalized "knowledge" concerning various aspects of the Company's business. See AC ¶¶ 39, 50, 51, 58. Five others, while allegedly employed by Freddie Mac during the class period, are cited only as to matters outside the scope of the class period, or, in two cases, have alleged observations attributed to them that are not specific at all as to time-frame. See AC ¶¶ 41, 42, 49, 54, 60. Four others are cited to support generalized report allegations or concerning accounting practices that are not

rise to any cogent, let alone compelling, inferences whatsoever; indeed, none of them is alleged to have ever met or spoken with any of the Individual Defendants.

The first of these three sources, the former Director of Operational Risk Management, claims that Mr. Piszel said that Freddie Mac is "well capitalized" and that "those [subprime] risks are not a threat to Freddie Mac[,]" and he or she opines that those statements were "bullsh**t" and "not substantiated." AC ¶¶ 230-31.[38] That invective is not a specific fact, and in any case is allegedly based on meetings in "August 2007" -- **prior to** the class period. AC ¶ 230. The allegations attributed to this source fail to suggest that Mr. Piszel was aware of any specific fact contrary to what he allegedly stated internally.

Second, a former Senior Financial Analyst claims that Freddie Mac's Note 2 disclosures "were deficient" because they combined two separate types of transactions, cash and swap transactions. AC ¶¶ 264-65. The witness allegedly received an email from Mr. Piszel relating to the "Note 2 disclosures" in the **2006** annual report, in which Mr. Piszel asked a question about "prepayment rate assumptions." AC ¶ 270. Based on this email exchange prior to the class period, the AC merely alleges that Mr. Piszel "reviewed the Company's Note 2 disclosures and knew the disclosures did not show the cash transactions separately, as indicated by, among other things, an e-mail Piszel sent directly to [the] employee." AC ¶ 265. These allegations are totally insufficient. To begin, the AC does not actually challenge the accuracy of any "Note 2 disclosures" made during the class period. See AC ¶¶ 264-74. Furthermore, the AC does not allege that this employee ever discussed the alleged Note 2 "deficiencies" with Mr. Piszel or anyone else at Freddie Mac, or that Mr. Piszel knew of any alleged material misstatement or omission with regard to any challenged statement during the class period.

Third, a former Senior Transaction Manager first cited in AC ¶ 48 states that Ms. Cook told "Company employees" that Freddie Mac "got into this mess to retain market share and stay

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indicative of fraud. See AC ¶¶ 40, 44, 45, 62. The two remaining witnesses are cited for mere trivia respecting Freddie Mac's business and rank hearsay. See AC ¶¶ 43, 184; AC ¶¶ 52, 252-54.

[38] Incredibly, Plaintiff's attorneys inserted the word "subprime" in brackets, making it clear that the confidential witness's own statement did not contain the word "subprime," and that Plaintiff's counsel is supplying its own interpretation of the witness's recollection as to what Mr. Piszel allegedly said on some unspecified date.

relevant." AC ¶ 108. Plaintiff fails to allege that this witness personally heard the remark, let alone how the statement is indicative of any fraud. This witness similarly "recalled" that Mr. Syron "always said you 'shouldn't be proud to be number two in a duopoly.'" Id. Plaintiff then jumps to the unwarranted, unsupported, and vague conclusion that this meant that "Syron wanted Freddie Mac to increase its market share vis-à-vis Fannie Mae – **at any cost**." Id. (emphasis added). None of these allegations support any inference of fraud whatsoever, as they fail to allege that any Defendant knew any specific and contemporaneous fact that was contrary to any challenged statement.

As in 380544 Canada, Inc. v. Aspen Tech., Inc., the confidential witness allegations of this AC contain "no allegations of fact" to support any inference that any Defendant participated in or knew about any fraud. 544 F. Supp. 2d 199, 229 (S.D.N.Y. 2008). At most, Plaintiff's confidential witnesses offer only what amounts to "water-cooler gossip, irrelevant speculation, and gratuitous criticism[.]" See In re Ferro Corp., Nos. 04-1440, 04-1589, 2007 WL 1691358, at *12 (N.D. Ohio June 11, 2007) (quotation marks omitted); see also Downey, 2009 WL 2767670, at *10 (holding confidential witness statements "deficient because they lack[ed] specificity" and were "based on hearsay, rumor, or speculation"). Such conclusory allegations are insufficient to satisfy the strict pleading requirements of the PSLRA and Rule 9(b).

4. Plaintiff's Allegations Based On Statements Made Before Congress And By Public Officials And The Pendency Of Investigations Do Not Support Any Inference Of Scienter.

Plaintiff attempts to buttress its unsubstantiated allegations with statements made during Congressional hearings, other statements attributed to various public officials, the declaration of a former Chief Credit Officer of Fannie Mae, and the mere existence of governmental investigations.[39] This reliance is misplaced and does not support any inference of scienter.

When viewed in their proper context, the statements on which Plaintiff relies are entitled to little weight. It is common knowledge that the GSEs have long been a political football,

[39] See AC at 51, 84; AC ¶¶ 13, 88, 123, 124, 141, 161, 162, 163, 166, 290, 291, 298, 302, 303, 304, 305, 306, 307-10, 395, 396, 398, 500, 529; AC, Ex. C (Declaration of Edward Pinto).

eliciting much criticism from their opponents. See, e.g., App. 77 (Zachary A. Goldfarb, Republican Says Documents, Raines' Statements are at Odds, Wash. Post, Mar. 5, 2009) (noting that Fannie Mae has been a "target[] of GOP criticism for years").[40] Many of Plaintiff's allegations are based on statements made during the December 9, 2008 hearing "The Role of Fannie Mae and Freddie Mac in the Financial Crisis," which, naturally, featured criticism of the GSEs by longtime political opponents.[41] These comments, many of which Plaintiff pulls from context,[42] lack foundation and fail to support any inference of fraud. Like the statements by the vast majority of Plaintiff's confidential witnesses, see supra Part II.B.3, statements by the GSEs' opponents are entitled to no weight because the speakers: (a) did not work at Freddie Mac during the class period; and (b) had no personal knowledge of any Defendant's state of mind.[43]

As courts have long recognized, "[t]he complaint must rise or fall on allegations about defendants' conduct and not on wide-eyed citation to the gratuitous commentary of outsiders. Such commentary is irrelevant to plaintiff's claims." Hershfang v. Citicorp, 767 F. Supp. 1251, 1255 (S.D.N.Y. 1991). Indeed, conclusory allegations have no probative value even if made by a supposed expert on the topic. See, e.g., Evers v. General Motors Corp., 770 F.2d 984, 986 (11th Cir. 1985) (expert affidavit had "no probative value" since it contained "conclusory

[40] See generally App. 46 at 1 (Ed Roberts, Fannie Mae Execs Defend Accounting, 8 Credit Union J., Oct. 12, 2004) (noting that a prior hearing was a "highly charged political showdown" that "had a decidedly partisan edge, with Republican members of the committee critical of [the GSE] and its executives, and Democrats supportive and dismissive of the OFHEO findings"); App. 45 at 4 (Rob Blackwell, Fannie and OFHEO Take Lumps in House Hearing, Am. Banker, Oct. 7, 2004) (noting that Democrats and Republicans "split largely along partisan lines" in "an occasionally contentious" hearing regarding past allegations regarding Fannie Mae's accounting).

[41] For example, Plaintiff relies on statements by Charles W. Calomiris during the December 9, 2008 Congressional hearing, and on various papers written by Calomiris with Peter J. Wallison regarding Freddie Mac's risk exposure. See AC ¶¶ 13, 133, 166, 306. Calomiris and Wallison are not neutral experts speaking on the topic, but instead are well-known critics of the GSEs. Calomiris and Wallison co-direct the American Enterprise Institute's Financial Deregulation Project, which "has been critically appraising the activities of [Fannie Mae and Freddie Mac] for several years." See American Enterprise Institute Website, at http://www.aei.org/research/contentID.20040927152122935/default.asp. Calomiris has teamed up with Wallison on other occasions to publish negative commentary on the GSEs. See, e.g., App. 68 (Charles W. Calomiris & Peter J. Wallison, Blame Fannie Mae and Congress for the Credit Mess, Wall St. J., Sept. 23, 2008).

[42] Compare AC ¶ 305 (omitting text: "Because of customs developed years ago in the mortgage markets, subprime and Alt-A loans may show up in both subprime and prime databases."), with App. 75 at 2.

[43] See, e.g., AC ¶¶ 88, 303-04 (comments by Representatives Carolyn Maloney, Mark Souder, and testimony from Arnold Kling); AC ¶¶ 124, 161, 163 (relying on statements by Edward Pinto, who never worked at Freddie Mac); AC ¶¶ 13, 396 (relying on statements by Senator Richard Shelby, a long-time opponent of the GSEs).

allegations without specific supporting facts”).

Plaintiff’s allegations regarding governmental investigations (AC ¶¶ 307-10) also fail as a matter of law to raise any inference of scienter. See, e.g., In re Hutchinson Tech., Inc. Sec. Litig., 536 F.3d 952, 962 (8th Cir. 2008) (“The mere existence of an SEC investigation does not suggest that any of the allegedly false statements were actually false and it does not render . . . statements . . . material nor does it add an inference of scienter.”).[44]

5. Plaintiff’s “Motive And Opportunity” Allegations Do Not Support A Strong Inference Of Scienter.

Plaintiff alleges that Defendants possessed a motive to commit the alleged fraud based upon alleged insider trading and executive compensation. Plaintiff’s allegations of motive and opportunity do not give rise to a strong inference of scienter. It is “well established” that, to plead motive as a basis for an inference of scienter, plaintiff must allege “concrete benefits that can be obtained as a result of the alleged misstatements or omissions.” Fort Worth Employers’ Retirement Fund v. Biovail Corp., 615 F. Supp. 2d 218, 225 (S.D.N.Y. 2009) (citation omitted). A “‘generalized motive, one which could be computed to any publicly owned, for-profit endeavor’” is not enough.’” Id. (quoting Chill v. Gen. Elec. Co., 101 F.3d 263, 267 (2d Cir. 1996)). Accordingly, as discussed below, Plaintiff’s “motive and opportunity” allegations do not support any inference of scienter regarding any challenged statement.

a. The Absence Of Sales By Freddie Mac’s CEO, CFO, And COO, And The Substantial Losses They Incurred, Undermines Any Inference Of Scienter.

Plaintiff does not allege that any Individual Defendant sold any Freddie Mac stock during the class period. Further, as the relevant Forms 4 filed with the SEC indicate, these defendants -- the Company’s former CEO, Richard F. Syron, former CFO, Anthony Piszel, and former Chief Business Officer and Executive Vice President for Investments and Capital Markets, Patricia

[44] See also In re Spectrum Brands, Inc. Sec. Litig., 461 F. Supp. 2d 1297, 1318 & n.8 (N.D. Ga. 2006) (granting motion to dismiss where suspicious sales prompting DOJ and SEC investigations were not alone sufficient to raise strong inference of scienter); City of Austin Police Ret. Sys. v. ITT Educ. Serv., Inc., 388 F. Supp. 2d 932, 942 (S.D. Ind. 2005) (dismissing claims, stating “the mere existence of [a federal criminal] investigation cannot support any inferences of wrongdoing or fraudulent scienter on the part of the company or its senior management”).

Cook -- **sold no stock at all** during that time. See App. 41 (Individual Defendant Trading Exhibit and Related Forms).[45]

As the Forms 4 show, Mr. Syron, Ms. Cook and Mr. Piszel collectively held 1,273,736 shares and exercisable options as of the end of the class period -- yet they had no "sales" during that time. App. 41.[46] Consequently, the value of Mr. Syron's holdings declined by more than **$25 million** from the class period high of $37.10 on December 6, 2007, to the opening of trading on the last trading day of the class period ($4.80 on September 5, 2008). Id.; App. 42 (List of Historical Prices of Freddie Mac Stock (Aug. 1, 2006 - Sept. 12, 2008)). Similarly, the value of Mr. Piszel's holdings declined by more than **$7 million**, and the value of Ms. Cook's holdings declined by more than **$6 million** during that same period. Id.

This absence of stock sales belies any suggestion that the Defendants made misrepresentations in order to sell company stock at an inflated price, and negates any inference of scienter. See San Leandro Emergency Med. Group, 75 F.3d at 814 ("[T]he fact that other defendants did not sell their shares during the relevant class period sufficiently undermines plaintiffs' claim regarding motive.") (citation omitted); In re First Union Corp. Sec. Litig., 128 F. Supp. 2d 871, 899 (W.D.N.C. 2001) (fact that CFO and other executives "did not sell a single share . . . is fatal to Plaintiffs' effort to establish scienter through stock sales").

On the contrary, where, as here, defendants suffer enormous investment losses (here, over **$40 million**), courts find it implausible that such defendants possessed any intent to defraud. See, e.g., Maldonado v. Dominguez, 137 F.3d 1, 12 n.9 (1st Cir. 1998) (noting that any inference of scienter was undermined by defendants' loss of $1.5 million); In re Downey Sec. Litig., No.

[45] The trading activity of the Individual Defendants is summarized in the chart attached at App. 41, which is supported by the Forms 4 also included at App. 41.

[46] As the relevant Forms 4 plainly indicate, every single "sale" alleged in the prior version of the AC by Freddie Mac's CEO, CFO, or EVP was **not** a **sale**, but a "**forfeiture**." See id. (Individual Defendant Trading Exhibit and Related Forms) (emphasis added). Forfeitures -- which are not sales, and which, in this case, occurred "automatically" -- cannot give rise to any inference of scienter. See South Ferry LP No. 2 v. Killinger, 399 F. Supp. 2d 1121, 1144 (W.D. Wash. 2005) (dismissing securities claims, rejecting allegation that forfeitures gave rise to inference of scienter), vacated in part on other grounds, 542 F.3d 776 (9th Cir. 2008); see also In re Sportsline.com Sec. Litig., 366 F. Supp. 2d 1159, 1173 (S.D. Fla. 2004) (rejecting allegation that forfeitures of small percentages of holdings gave rise to any inference of scienter).

08-3261, 2009 WL 736802, at *14 (C.D. Cal. Mar. 18, 2009) (finding that losses suffered by defendants due to their failure to sell any stock "negates any inference of scienter").

b. Plaintiff's Allegations Concerning The Individual Defendants' Compensation <u>Cannot Support Any Inference of Scienter.</u>

Plaintiff conclusorily asserts that Freddie Mac's alleged "pay for performance" executive compensation policy "gave the Individual Defendants incentive to grab short-term profits and market share at the cost of the Company's and shareholders' long-term interests." AC ¶¶ 127-29. Numerous courts have held that this type of conclusory motive allegation -- merely asserting that a defendant's compensation is tied to company performance -- is insufficient to raise a strong inference of scienter. <u>See, e.g.</u>, <u>Kalnit v. Eichler</u>, 264 F.3d 131, 139 (2d Cir. 2001) ("Motives that are generally possessed by most corporate directors and officers do not suffice [to plead scienter]; instead, plaintiffs must assert a concrete personal benefit to the individual defendants resulting from the fraud.") (citation omitted).

Here, Plaintiff has failed to plead specific facts regarding the Individual Defendants' compensation, let alone how the Company's compensation policies relate to any of the challenged statements. Indeed, while citing a press release regarding compensation paid in 2007, Plaintiff does not allege what the compensation policy was during 2008, other than describing in generic terms that executives were rewarded based on the Company's performance. AC ¶¶ 129, 132, 133. Further, the Company reported net losses each quarter in the class period, so the allegations that Defendants were seeking to "grab short term profits" is nonsensical and cannot therefore give rise to any inference of scienter.

* * *

Even taken together, Plaintiff's empty scienter allegations do not give rise to a strong inference of scienter. <u>See</u> <u>In re Carter-Wallace, Inc. Sec. Litig.</u>, No. 94-5704, 1999 WL 1029713, at *5 (S.D.N.Y. Nov. 10, 1999) (dismissing claims and stating: "Four cubic zirconias will never add up to one real diamond and neither will four generic motives add up to one or more specific motives."), <u>aff'd</u>, 220 F.3d 36 (2d Cir. 2000). Plaintiff has failed to allege specific

facts giving rise to a strong inference of scienter, and the AC should be dismissed for this reason alone. See Garber v. Legg Mason, Inc., 537 F. Supp. 2d 597, 615 (S.D.N.Y. 2008).

Moreover, Tellabs requires courts to weigh competing inferences when assessing whether a securities complaint adequately alleges a strong inference of scienter. 551 U.S. at 323-24. Here, as in many cases arising from the recent economic crisis,[47] the facts pled give rise to a far stronger inference that investor losses resulted, not from any fraud, but rather from the historically unprecedented decline in the housing market. For this independent reason, Plaintiff's fraud claims should be dismissed. See Tellabs, 551 U.S. at 323-24.

III. THE AMENDED COMPLAINT SHOULD ALSO BE DISMISSED UNDER RULE 12(b)(6) BECAUSE THE PLAINTIFF HAS FAILED TO ALLEGE ANY ACTIONABLE MISREPRESENTATIONS OR OMISSIONS OF MATERIAL FACT.

In addition to failing under the PSLRA and Rule 9(b), Plaintiff's allegations also fall short under Rule 12(b)(6) because Plaintiff has failed to allege any omission of material fact (see infra Part III.A) or misstatement of material fact (see infra Part III.B) actionable under Section 10(b). As noted above, to survive dismissal under the standard of Twombly and Iqbal, a complaint cannot be conclusory or rely on speculation, but rather must have a certain "heft." Twombly, 550 U.S. at 545; Iqbal, 129 S. Ct. at 1951. Plaintiff fails to meet this standard, and its claims should be dismissed for this reason as well.

A. Plaintiff Has Not Alleged Any Omission Of Material Fact Actionable Under Section 10(b).

Plaintiff asserts that Defendants made numerous omissions of material fact. See, e.g., AC ¶ 452. Plaintiff's contentions are without merit. It is well settled that "[s]ilence, absent a duty to

[47] See, e.g., PXRE Group, 600 F. Supp. 2d at 546 ("Taken collectively, Plaintiff's factual allegations suggest an industry, and a company, shocked by a unique and devastating catastrophe."); Huntington BancShares, 620 F. Supp. 2d at 853 (dismissing "stock drop case[]" where company's financial difficulties were part of the "economic climate in general, which of course includes the subprime lending crisis"); Pittleman, 2009 WL 648983, at *4 ("This case is about a company involved in a volatile industry at the onset of a long, destructive economic downturn."); Novastar, 2008 WL 2354367, at *4 ("Plaintiff's allegations are more consistent with a company and executives confronting a deterioration in the business and finding itself unable to prevent it than they are with a company and executives recklessly deceiving the investing community."); Tripp v. Indymac Fin. Inc., No. 07-1635, 2007 WL 4591930, at *4 (C.D. Cal. Nov. 29, 2007) ("[A]n even stronger inference is that Defendants were simply unable to shield themselves as effectively as they anticipated from the drastic change in the housing and mortgage markets and, once that inability became evident, [their] financials were changed accordingly.").

disclose, is not misleading under Rule 10b-5." Basic, Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988). "[A]n omission is actionable under the securities laws only when the corporation is subject to a duty to disclose." In re Time Warner Inc. Sec. Litig., 9 F.3d 259, 267 (2d Cir. 1993) (emphasis added). A duty to disclose arises only in the following three instances: (1) when a statute requires disclosure; (2) when there is contemporaneous insider trading; or (3) when there is an inaccurate, incomplete or misleading prior disclosure. See Glazer v. Formica Corp., 964 F.2d 149, 157 (2d Cir. 1992). Materiality alone is not sufficient to place a company under a duty to disclose. Id. To hold otherwise would flood investors with marginally useful information and would limit a corporation's legitimate need to keep some information nonpublic. See Time Warner, 9 F.3d at 268 ("We do not hold that whenever a corporation speaks, it must disclose every piece of information in its possession.").[48]

Freddie Mac had no duty to disclose the allegedly omitted information. As explained below: (1) Plaintiff does not allege that any actual statement was "so incomplete as to mislead"; (2) Plaintiff's allegations of business mismanagement do not state a claim for violation of the federal securities laws; and (3) Defendants disclosed much of the allegedly omitted information.

1. Plaintiff Does Not And Cannot Allege That Any Actual Statement Was "So Incomplete As To Mislead."

A statement that is allegedly "so incomplete as to mislead" is only actionable under very limited circumstances. See Backman v. Polaroid Corp., 910 F.2d 10, 16 (1st Cir. 1990) (applied in Glazer, 964 F.2d at 156).[49] The First Circuit's en banc ruling in Polaroid illustrates how very narrowly courts construe what it means for a statement to be "so incomplete as to mislead." Id. at 16. In Polaroid, the plaintiffs alleged, inter alia, that certain of Polaroid's disclosures concerning the sales price and number of sales of its Polavision instant movie camera (which

[48] In the Second Circuit, courts distinguish "hard facts" or "hard information" -- information that "definitely affect[s] a company's financial prospects" -- from "soft information" -- forecasts, predictions, and matters of opinion. See In re Ames Dept. Stores Inc. Stock Litig., 991 F.2d 953, 964 n.4 (2d Cir. 1993). No duty exists to disclose soft information, including internal forecasts, unless "worded as guarantees" or "supported by specific statements of fact." In re Int'l Bus. Machs. Corp. Sec. Litig., 163 F.3d 102, 107 (2d Cir. 1998).

[49] See also Winer Family Trust v. Queen, 503 F.3d 319, 330 (3d Cir. 2007) (applying Polaroid in affirming dismissal of securities fraud claims); K-tel, 300 F.3d at 897 (same).

proved to be a commercial disaster) were misleading in violation of the federal securities laws. Id. at 15. In its ruling, the First Circuit stressed that "complete and accurate" disclosure does not require that a company publish every fact about every subject it voluntarily discloses: "This, however, does not mean that by revealing one fact about a product, one must reveal all others that, too, would be interesting, market-wise, but means only such others, if any, that are needed so that what was revealed would not be 'so incomplete as to mislead.'" Id. at 16. Applying this principle to the plaintiff's allegations, the court found that Polaroid was not required to disclose other, related information regarding sales and pricing: "Disclosing that Polavision was being sold below cost was not misleading by reason of not saying how much below. Nor was it misleading not to report the number of sales, or that they were below expectations." Id.

Just as in Polaroid, Plaintiff's conclusory allegations fail to indicate how any of the alleged statements were "so incomplete as to mislead." As discussed above, nowhere does Plaintiff allege how any challenged statement was misleading by virtue of any alleged omission, instead leaving it to the Court and Defendants to guess at Plaintiff's contentions. While Plaintiff has quoted en masse allegedly false statements, it fails to allege any well-pled facts that were omitted from such statements that rendered them misleading. Accordingly, Plaintiff has not alleged any omission of material fact that is actionable under Section 10(b).

2. Allegations Of Business Mismanagement Do Not State A Claim For Violation Of The Federal Securities Laws.

Many of the omissions the Plaintiff alleges are also not actionable because they amount to no more than claims of supposed corporate mismanagement. Such allegations cannot support a federal securities law claim, as a matter of law. See Santa Fe Indus., Inc, v. Green, 430 U.S. 462, 479 (1977) ("Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement.") (quotations and citations omitted); In re Citigroup, Inc. Sec. Litig., 330 F. Supp. 2d 367, 375-76 (S.D.N.Y. 2004) (dismissing allegations that defendants failed to adhere to risk management policies as corporate mismanagement claims, not actionable as securities fraud).

Indeed, courts have recently granted motions to dismiss securities fraud claims founded on allegations of corporate mismanagement that are strikingly similar to Plaintiff's allegations. See, e.g., Novastar, 2008 WL 2354367, at *4 (dismissing, with prejudice, claims based on subprime loan investments and noting: "Plaintiff's Complaint reads more like a cautionary tale from a treatise on business management than a charge of knowing misstatements and concealments. Plaintiff has not stated a claim because companies (and their management) are not expected to be clairvoyant, and bad decisions do not constitute securities fraud."), aff'd, --- F.3d ---, 2009 WL 2747281 (8th Cir. Sept. 1, 2009); In re Impac Mortgage Holdings, Inc. Sec. Litig., 554 F. Supp. 2d 1083, 1087 (C.D. Cal. 2008) (dismissing claims based on defendant's investment in Alt-A mortgages where, inter alia, plaintiffs' allegations amounted to corporate mismanagement "not actionable fraud under the securities laws"); IndyMac, 2007 WL 4591930, at *3-4 (allegations that defendant inappropriately loosened underwriting guidelines alleged only corporate mismanagement, and increases in loss reserves indicated only that "Defendants were simply unable to shield themselves as effectively as they anticipated from the drastic change in the housing and mortgage markets"); see also Downey, 2009 WL 2767670, at *11 ("[T]he second-guessing of management decisions by confidential witnesses does not provide a basis for securities fraud.").

As in the above cases, Plaintiff's allegations with respect to numerous subjects amount to no more than non-actionable charges of supposed mismanagement. The following are just a few of the more prominent examples of actions, inaction, and decisions that Plaintiff criticizes:

- Freddie Mac's publicly disclosed decision to purchase subprime and non-traditional mortgage products (AC ¶¶ 9, 82, 94-96, 99-100, 123, 221, 224);
- Alleged expansion into subprime and non-traditional mortgage products through the "Touch More Loans" and "XMC" programs (AC ¶¶ 103-108, 115, 131);
- Alleged decision to transact structured deals with large investment banks (AC ¶¶ 170-74);
- Alleged failure by Freddie Mac management to heed a memorandum from then-employee David Andrukonis, issued in 2004, that buying certain loans "would likely pose an enormous financial and reputational risk to the company and the country" (AC ¶ 10);
- Alleged operation at a high leverage ratio based on core capital (AC ¶ 93);

- Alleged decisions by Freddie Mac to adjust underwriting standards and due diligence requirements (AC ¶¶ 117, 148, 193-99, 201, 203, 207-09, 403);
- Alleged failure to comply with own policy of purchasing only the most protected tranches of MBS (AC ¶ 118);
- Alleged failure to avoid purchasing so-called "piggyback" loans (AC ¶¶ 119-22);
- Alleged deficiencies in accounting systems and practices (AC ¶¶ 134, 182-85, 264-74, 318, 321, 429-39);
- Alleged deficiencies in Loan Prospector automated underwriting system (AC ¶¶ 176-81, 191, 399);
- Alleged decision not to audit more loans (AC ¶ 205);
- Alleged decision to tranche interest rate risk rather than credit risk (AC ¶ 212);
- Alleged deficiencies in fraud detection systems and a supposed failure to implement a product offered by CoreLogic (AC ¶¶ 213-17);
- Alleged failure to purchase more credit enhancements on pools of loans to mitigate risk (AC ¶¶ 244, 399);
- Alleged decisions to change elements of internal financial reports (AC ¶¶ 259-60);
- Alleged decisions regarding impairment using allegedly outdated models (AC ¶¶ 279-81);
- Alleged failure to run a VAR analysis to assess market risk (AC ¶¶ 282-84).

Furthermore, as the very recent ruling by Chancellor Chandler of the Delaware Chancery Court makes clear, such allegations are not even sufficient to allege claims for breach of fiduciary duty under state law, let alone claims of fraud under federal securities law. In <u>In re Citigroup, Inc. S'holder Deriv. Litig.</u>, shareholders alleged that Citigroup directors and officers breached their fiduciary duties by failing properly to monitor and manage the risks Citigroup faced from subprime lending and by failing to disclose the extent of its exposure to subprime assets. 964 A.2d 106, 111 (Del. Ch. 2009). Citigroup had watched its stock price drop more than 87% in 2008, and it would have faced bankruptcy if not for the bailout by the U.S. government. <u>See</u> App. 74 (David Enrich, et al., <u>U.S. Agrees to Rescue Struggling Citigroup</u>, Wall St. J., Nov. 24, 2008). The Delaware Chancery Court dismissed mismanagement-based claims on the grounds that plaintiffs had failed to plead bad faith with sufficient particularity. <u>Citigroup</u>, 964 A.2d at 128. In so holding, the court stressed that the management of a corporation, which requires business judgment, depends, at its core, on an assessment of risk. <u>Id.</u> at 126. Accordingly, as the court noted, the mere fact that a company knowingly takes on risk

and thereafter suffers enormous losses does not give rise to liability. Id. at 130. The court emphasized that it is not for the courts to second-guess business decisions merely because they led to substantial losses. Id. at 131.

In sum, none of Plaintiff's allegations regarding supposed mismanagement at Freddie Mac can support any of its claims in this action.

3. Defendants Disclosed Much Of The Allegedly Omitted Information.

Plaintiff's allegations that Freddie Mac omitted or concealed information suffer from yet another defect, which independently dictates the dismissal of the vast majority of Plaintiff's omission claims: Defendants actually disclosed much of the allegedly omitted information.

Where a plaintiff's claims are based on the alleged omission of information that was, in fact, disclosed, such claims are ripe for dismissal. See, e.g., Joffee v. Lehman Bros. Inc., No. 06-0903, 2006 WL 3780547, at *1 (2d Cir. Dec. 19, 2006) (affirming dismissal where "all of the facts which plaintiffs allege were concealed were, in fact, revealed in various public filings."). An examination of the alleged omissions, see, e.g., AC ¶¶ 3, 441-49, 452-54, 457-63, 465, along with Freddie Mac's relevant disclosures, reveals that the Company broadly disclosed to investors much of the allegedly omitted information.[50]

a. Freddie Mac Broadly Disclosed Its Investment In Subprime And Nontraditional Mortgages and the Risks Associated With Such Investment.

Plaintiff argues in various forms throughout the Amended Complaint that Defendants "continuously and consistently assur[ed] the market the Company had minimal exposure to the non-prime and non-traditional lending markets." AC ¶ 3. This allegation is belied by the very documents on which Plaintiff premises its claims. Before and throughout the proposed class period, Freddie Mac plainly disclosed to investors that, consistent with its mission, it planned to, and did, participate in the subprime and nontraditional mortgage markets. In addition, while the

[50] Freddie Mac does not argue that it disclosed all of the allegedly omitted information because some of the allegedly omitted "facts" are not facts at all, but rather just conclusory assertions, unsupported by the particularized pleading necessary to survive a motion to dismiss. See supra Parts II.A.1, II.B.2.

market was capable of assessing on its own the obvious fact that subprime and nontraditional mortgage products give rise to greater risk of loss than prime mortgage products, Freddie Mac also specifically disclosed that such participation involved an increased level of risk.

For example, in its 2006 Annual Report, Freddie Mac disclosed its participation in the subprime and other nontraditional mortgage markets: "To improve our ability to fulfill our mission, **we have increased our participation in nontraditional mortgage market products**." App. 2 at 68 (2006 Annual Report) (emphasis added). Freddie Mac also disclosed the accompanying enhanced risk: "**We increased our purchases** of . . . **variable-rate and non-traditional mortgage products** as they became more prevalent in the market. . . . We generally seek higher compensation for the **additional credit risk inherent in these products** . . . ." App. 2 at 24 (2006 Annual Report) (emphasis added).

In addition, Freddie Mac disclosed hard facts regarding that participation, including the approximate amount of securities backed by subprime mortgages:

- [I]ncluded in our credit guarantee portfolio are Structured Securities backed by non-agency mortgage-related securities **where the underlying collateral was identified as being subprime by the original issuer.** At December 31, 2006 and 2005, the Structured Securities **backed by subprime mortgages constituted approximately 0.1 percent and 0.2 percent**, respectively of our credit guarantee portfolio. App. 2 at 69 (2006 Annual Report) (emphasis added).
- With respect to our Retained portfolio, we do not believe that any meaningful amount of the agency securities we hold is backed by subprime mortgages. **However, at December 31, 2006 and 2005, we held approximately $124 billion and $139 billion, respectively, of non-agency mortgage-related securities backed by subprime loans.** App. 2 at 69 (2006 Annual Report) (emphasis added); see also id. at 68-69 (discussing the Company's expansion in product types such as interest-only and option ARM loans and participation in subprime).

And in its November 20, 2007 supplement to the 2006 Annual Report, released on the day the proposed class period begins, Freddie Mac disclosed an increase in its involvement in the subprime and other nontraditional mortgage markets:

- [I]n April 2007, we announced that we will purchase **up to $20 billion in fixed-rate and hybrid ARM products that will provide lenders with more choices to offer subprime borrowers.** These initiatives **may also adversely affect our profitability** or our ability to achieve our affordable housing goals and subgoals. App. 6 at 76 (Supp. to the 2006 Information Statement & Annual Report) (emphasis added).
- The proportion of higher risk mortgage loans that were originated in the market during the last four years increased significantly. **We have increased our securitization**

volume of non-traditional mortgage products, such as interest-only loans as well as loans originated with lower documentation in the last two years in response to the prevalence of these products within the origination market. App. 6 at 75 (Supp. to the 2006 Information Statement & Annual Report) (emphasis added).

Freddie Mac also disclosed specific facts regarding the extent of that participation:

- Total **non-traditional mortgage products, including those designated as Alt-A and interest-only loans, made up approximately 33% and 24% of our single-family mortgage purchase volume in the nine months ended September 30, 2007 and 2006, respectively.** Consequently, our increased purchases of these mortgages and issuances of guarantees on them expose us to **greater credit risks.** We **expect to experience increased delinquencies and credit losses**, which will likely reduce our earnings in future periods and could adversely affect our results of operations or financial condition. App. 6 at 76 (Supp. to the 2006 Information Statement & Annual Report) (emphasis added).
- **At September 30, 2007 and December 31, 2006, we held investments of approximately $105 billion and $124 billion, respectively, of single-family non-agency mortgage-related securities backed by subprime loans** . . . . **At September 30, 2007 and December 31, 2006, we believe that $53 billion and $54 billion, respectively, of our single-family non-agency mortgage-related securities that are not backed by subprime loans are generally backed by Alt-A mortgage loans.** App. 6 at 21 (Supp. to the 2006 Information Statement & Annual Report) (emphasis added).
- **We estimate that approximately $5 billion and $3 billion of loans underlying our Structured Transactions at September 30, 2007 and December 31, 2006, respectively, were classified as subprime mortgage loans.** With respect to our retained portfolio, at **September 30, 2007 and December 31, 2006, we held investments of approximately $105 billion and $124 billion, respectively, of non-agency mortgage-related securities backed by subprime loans.** App. 6 at 33 (Supp. to the 2006 Information Statement & Annual Report) (emphasis added).

In the 2007 Annual Report released on February 28, 2008, Freddie Mac again disclosed the fact of its participation in the subprime and other nontraditional mortgage markets. App. 7 at 14 (2007 Annual Report). In addition, Freddie Mac noted the enhanced risks of subprime investment and the downturn in the housing market, particularly the subprime sector:

- The credit performance of subprime and Alt-A loans, as well as other non-traditional mortgage products, deteriorated during 2007. App. 7 at 3 (2007 Annual Report).
- "***We are exposed to increased credit risk related to subprime and Alt-A mortgage loans that back our non-agency mortgage-related securities investments***." App. 7 at 14 (2007 Annual Report) (emphasis in original).
- If delinquency and loss rates on subprime and Alt-A mortgages continue to increase, or there is a further decline in home prices, we could experience reduced yields or losses on our investments in non-agency mortgage-related securities backed by subprime or Alt-A loans. App. 7 at 14 (2007 Annual Report).

Further, Freddie Mac disclosed specific facts regarding the extent of that participation. The 2007 Annual Report contained a table titled, "Characteristics of Mortgage Loans and

Mortgage-Related Securities in our Retained Portfolio" and included specific line items for various "subprime" and "Alt-A" securities, which clearly set forth the amount of such investments for Freddie Mac. See App. 7 at 56, Table 22 (2007 Annual Report). The 2007 Annual Report also disclosed:

- We estimate that approximately **$6 billion and $3 billion of loans underlying our Structured Transactions at December 31, 2007 and 2006, respectively, were classified as subprime** mortgage loans. App. 7 at 94 (2007 Annual Report) (emphasis added).
- As of December 31, 2007, we have purchased approximately **$43 billion of conventional mortgages made to borrowers who otherwise might have been limited to subprime products**, including approximately $23 billion of refinance mortgages meeting our criteria. App. 7 at 94 (2007 Annual Report) (emphasis added).
- With respect to our retained portfolio, at December 31, 2007 and 2006, we held investments of approximately **$101 billion and $122 billion, respectively, of non-agency mortgage-related securities backed by subprime loans.** App. 7 at 94 (2007 Annual Report) (emphasis added).
- We believe that **$51 billion and $56 billion of our single-family nonagency mortgage-related securities that are not backed by subprime loans are generally backed by Alt-A mortgage loans at December 31, 2007 and 2006, respectively.** App. 7 at 94 (2007 Annual Report) (emphasis added).

Freddie Mac also disclosed, in exacting detail, the portions of its various portfolios that were exposed to subprime and other nontraditional mortgages. See, e.g., App. 14 at 9 (Nov. 20, 2007 Conference Call Tr.). Plaintiff does not challenge the accuracy of any of the hard data that Freddie Mac disclosed, which described with precision the extent of Freddie Mac's investment in subprime and nontraditional mortgages.

b. Freddie Mac Disclosed The Amount Of Its Capital Base, Its Minimum Capital Requirements, And The Risk That Its Capital Base May Decline Below Required Levels.

Plaintiff alleges that Freddie Mac deceived investors during the proposed class period because it "failed to disclose substantial and ongoing problems with the Company's capital adequacy[.]" See, e.g., AC ¶ 3. According to Plaintiff, "Instead of having the minimal exposure Defendants repeatedly trumpeted, Freddie Mac was in a position of precarious exposure and risk." AC ¶ 8. These allegations are belied by the very documents on which Plaintiff relies.

In its supplemental report issued on November 20, 2007, Freddie Mac disclosed:

> <u>**The sharp decline in the housing market and volatility in financial markets are adversely affecting our capital**</u>, including our ability to manage to the 30% mandatory target capital surplus. <u>**Factors that could adversely affect the adequacy of our capital**</u> in future periods <u>**include**</u> GAAP net losses; <u>**continued declines in home prices**</u>; increases in our credit and interest-rate risk profiles; adverse changes in interest-rate or implied volatility; adverse OAS changes; legislative or regulatory actions that increase capital requirements; or changes in accounting practices or standards. App. 6 at 26 (Supp. to the 2006 Information Statement & Annual Report) (emphasis added).

The report sets forth a list of actions Freddie Mac planned to take in order to manage to the 30% mandatory target capital surplus, including engaging Goldman, Sachs & Co. and Lehman Brothers as financial advisors to help Freddie Mac review capital-raising alternatives and considering reducing the fourth quarter stock dividend by 50%. The report also warned that "[o]ur ability to execute any of these actions or their effectiveness may be limited and we might not be able to manage to the 30% mandatory target capital surplus." App. 6 at 6 (Supp. to the 2006 Information Statement & Annual Report).

A press release issued on November 27, 2007 provided further details on Freddie Mac's capital position, stating that, while the Company had estimated regulatory core capital of approximately $34.6 billion at September 30, 2007, it had a surplus of only $0.6 billion in excess of the 30 percent mandatory target capital surplus imposed by OFHEO. App. 15 (Nov. 27, 2007 Press Release).

Freddie Mac's 2007 Annual Report, issued on February 22, 2008, similarly warned that "[w]eaknesses in the housing market and volatility in the financial markets continue to adversely affect our capital, including our ability to manage to the 30% mandatory target capital surplus," and repeated earlier warnings regarding factors that could affect the adequacy of Freddie Mac's capital, as well as remedial steps being taken to manage to the mandatory target capital surplus. App. 7 at 32 (2007 Annual Report). In addition, it disclosed that "[a]s a result of the impact of GAAP net losses on our regulatory core capital, our estimated capital surplus was below the 30% mandatory target capital surplus at the end of November 2007." <u>Id.</u>

In fact, Freddie Mac repeatedly and accurately disclosed its core capital position to investors and, contrary to Plaintiff's allegation, the specific amount by which its core capital exceeded OFHEO's 30 percent minimum target capital surplus. <u>See</u> <u>supra</u> pp. 12-13.

At bottom, Plaintiff does not -- because it cannot -- explain how Defendants could possibly have failed to disclose problems with Freddie Mac's capital adequacy when Freddie Mac accurately disclosed its core capital levels, their relation to OFHEO's minimum capital surplus requirement, and the risks to its ability to meet that requirement.

c. Freddie Mac Made More Than Adequate Disclosures Regarding Its Due Diligence And Underwriting.

Plaintiff incorrectly claims that Defendants conducted inadequate due diligence on loans as part of the Company's underwriting process, and that Freddie Mac concealed or made misrepresentations about these inadequacies. Specifically, Plaintiff claims that Freddie Mac misled the public because it: (a) outsourced certain due diligence functions to a third party, Clayton (AC ¶ 190); (b) delegated underwriting to the Wall Street firms that were its customers (AC ¶¶ 195-97); and (c) did not have adequate computer systems in place to conduct an automated review of all loans (AC ¶ 217). Plaintiff does not connect any of these alleged issues to any loss about which it complains, and these issues constitute non-actionable claims of alleged corporate mismanagement. Moreover, Freddie Mac did disclose both the facts and risks related to its underwriting processes:

- ***We rely on third parties for certain functions that are critical to financial reporting, our retained portfolio activity and mortgage loan underwriting. Any failures by those vendors could disrupt our business operations.*** App. 7 at 20 (2007 Annual Report) (emphasis in original).
- We use a process of delegated underwriting for the single-family mortgages we purchase or securitize. In this process, we provide originators with a series of mortgage underwriting standards and the originators represent and warrant to us that the mortgages sold to us meet these requirements. App. 7 at 90 (2007 Annual Report).
- We provide originators with written standards and/or automated underwriting software tools, such as Loan Prospector.® . . . The percentage of our single-family mortgage purchase volume evaluated using Loan Prospector® prior to purchase has declined over the last three years. App. 7 at 90-91 (2007 Annual Report).

d. Freddie Mac Issued Numerous Disclosures Regarding Material Weaknesses In Its Internal Controls.

Plaintiff alleges that "Defendants never disclosed during the entire Class Period the essential fact that Freddie Mac's systems and procedures . . . were either inadequate or so compromised by overrides as to lead to material misstatements of its financial position and to

cause it to take on massive levels of mortgage credit and interest rate risk." AC ¶ 452. Putting aside Plaintiff's failure specifically to connect these alleged issues to any loss about which Plaintiff complains, Freddie Mac did warn investors about risks arising from internal control deficiencies. For example:

> **Operational risks** are inherent in all of our business activities and **can become apparent in various ways, including** accounting or operational errors, business interruptions, **fraud**, failures of the technology used to support our business activities **and other operational challenges from failed or inadequate internal controls**. These operational risks may expose us to financial loss, interfere with our ability to sustain timely financial reporting, or result in other adverse consequences. . . . **[W]e continue to face challenges in ensuring that the new controls will operate effectively** . . . .

App. 7 at 109 (2007 Annual Report) (emphasis added).

B. The Statements Upon Which Plaintiff Bases Its Claims Are Not Actionable Under Section 10(b).

Just as Plaintiff has failed to state a claim against Defendants based on any **omission** of material fact, Plaintiff also has failed to state a claim based on any allegedly false or misleading **statement** of material fact. Every statement that Plaintiff challenges as an alleged misrepresentation is not actionable, as a matter of law.

Under longstanding principles of federal securities law, a plaintiff cannot predicate a claim for securities fraud on: (1) accurate statements of historical fact; (2) vague and indefinite statements of optimism about a company's business or future prospects; (3) forward-looking statements accompanied by meaningful cautionary language or language that "bespeaks caution"; (4) statements of third parties; or (5) characterizations of actual statements. Here, a statement-by-statement analysis of each alleged misrepresentation demonstrates that, under these legal doctrines, Plaintiff fails to plead a claim under Section 10(b), as a matter of law. See In re SCOR Holding (Switzerland) AG Litig., 537 F. Supp. 2d 556, 581 (S.D.N.Y. 2008) (a securities fraud plaintiff must plead fraud on a "statement-by-statement basis").

1. Accurate Statements Of Historical Fact Are Not Actionable.

Many statements included in Plaintiff's lengthy block quotes are not actionable, as a matter of law, because they are accurate statements of historical fact that are not challenged as

false. It is well settled that accurate statements of historical fact are not actionable under Section 10(b). See, e.g., In re Duane Reade Inc. Sec. Litig., No. 02-6478, 2003 WL 22801416, at *6 (S.D.N.Y. Nov. 25, 2003), aff'd sub nom. Nadoff v. Duane Reade, Inc., No. 03-9352, 2004 WL 1842801 (2d Cir. Aug. 17, 2004). In fact, "disclosure of accurate historical data does not become misleading even if [the company might predict] less favorable results . . . in the future." Id. (quoting In re Sofamor Danek Group, Inc., 123 F.3d 394, 401 n.3 (6th Cir. 1997)).

2. Vague And Indefinite Statements Of Optimism Are Immaterial, As A Matter Of Law.

Many of the alleged misrepresentations that Plaintiff challenges are not actionable because they are vague and indefinite statements of optimism that constitute immaterial puffery. Immaterial statements upon which a reasonable investor would not rely, such as "expressions of puffery and corporate optimism," cannot give rise to liability under the federal securities laws. Rombach v. Chang, 355 F.3d 164, 174 (2d Cir. 2004). Given that "companies must be permitted to operate with a hopeful outlook" and management "can be expected to be confident about their stewardship and the prospects of the business that they manage," courts dismiss securities fraud class actions predicated on such statements. Id. (quoting Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1129-30 (2d Cir. 1994)). As one court has observed:

> Courts everywhere "have demonstrated a willingness to find immaterial as a matter of law certain kinds of rosy affirmation heard from corporate managers and numbingly familiar to the marketplace -- loosely optimistic statements that are so vague, so lacking in specificity, or so clearly constituting the opinions of the speaker, that no reasonable investor could find them important to the total mix of information available."

Gavish v. Revlon, Inc., No. 00-7291, 2004 WL 2210269, at *20 (S.D.N.Y. Sept. 30, 2004) (quoting Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1217 (1st Cir. 1996)). Such puffery includes "loose optimism about both an issuer's current state of affairs and its future prospects." In re Peritus Software Servs. Inc. Sec. Litig., 52 F. Supp. 2d 211, 220 (D. Mass. 1999).

A large number of the statements that Plaintiff challenges contain statements or phrases that courts regularly hold to be inactionable corporate puffery. For example, generalized

optimistic statements concerning a company's risk management constitute mere puffery:[51]

> See, e.g., JP Morgan Chase Co., 553 F.3d at 205-06 (statements that company's risk management processes were "**highly disciplined**" and "**set the standard**" for "**integrity**" were "merely generalizations" that were "precisely the type of 'puffery' that this and other circuits have consistently held to be inactionable") (citation omitted) (emphasis added); In re New York Cmty. Bancorp Inc., Sec. Litig., 448 F. Supp. 2d 466, 478-79 (E.D.N.Y. 2006) reh'g denied, 244 F.R.D. 156 (E.D.N.Y. 2007) ("**generalizations regarding integrity, fiscal discipline, and risk management . . . amount to no more than inactionable puffery**"; statement that "[**the company's**] **greatest asset was that it is risk-averse** and **that strategy permeates every decision** the company makes" was not actionable) (emphasis added).

Similarly, courts hold statements containing phrases such as "well-positioned" when used to describe a company's competitive or market position to be inactionable as a matter of law:[52]

> See, e.g., Coble v. Broadvision, Inc., No. 01-1969, 2002 WL 31093589, at *1 (N.D. Cal. Sept. 11, 2002) (statement that company was "**well positioned** . . . to thrive and emerge an even a stronger player" not actionable) (emphasis added); Fitzer v. Sec. Dynamics Techs., Inc., 119 F. Supp. 2d 12, 23 (D. Mass. 2000) (statement that "[t]here are very **few companies** that **are positioned as well as us** and have the track record" and other statements "relating to whether [company] was '**well positioned**'" deemed no more than inactionable puffing) (emphasis added).

Statements using vague, generalized terms such as "strong" and "prudent" when used to describe, inter alia, a company's business, fundamentals, or performance are also considered immaterial puffery under the federal securities laws:[53]

> See, e.g., Rosenzweig v. Azurix Corp., 332 F.3d 854, 869 (5th Cir. 2003) (statement that "'**[o]ur fundamentals are strong**' is obviously immaterial puffery") (emphasis added); Next Century Commc'ns Corp. v. Ellis, 318 F.3d 1023, 1028 (11th Cir. 2003) (CEO's statement that company's performance was "**strong**" constituted mere puffery) (emphasis added); Impac, 554 F. Supp. 2d at 1097 (characterization of company's fundamentals, loan acquisitions and originations as "**solid**" was inactionable "vague expression of optimism"); Downey, 2009 WL 736802, at *6 (statements regarding defendant's "**strong capital position**" were "far too vague to be actionable under the PSLRA") (internal quotations omitted) (emphasis added); Frota v. Prudential-Bache Sec., Inc., 639 F. Supp. 1186, 1190 (S.D.N.Y. 1986) (assurances that investors' account would be "**properly and prudently managed**," that transactions were being carried out in a "**reasonable manner**," and that investors "**could trust**" defendant, constituted puffing and were not actionable) (emphasis added).

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[51] See AC ¶¶ 443, 446, 447, 459, 460, 472, 474, 479, 491, 539, 549.

[52] See AC ¶¶ 441, 445, 446, 447, 449, 453, 459, 460, 474, 479, 481, 489, 491, 510, 515, 519, 549.

[53] See AC ¶¶ 445, 447, 459, 472, 474, 479, 481, 489, 491, 504, 507, 510, 515, 519, 525, 526, 537, 539, 549, 558.

3. The PSLRA's Safe Harbor Provision And The "Bespeaks Caution" Doctrine Immunize Forward-Looking Statements Accompanied By Meaningful Cautionary Language.

Many of the challenged statements in this case were immunized from liability by the PSLRA's safe harbor provision for forward-looking statements or the "bespeaks caution" doctrine. Citing press releases, presentations and conference calls, Plaintiff challenges as false or misleading numerous forward-looking statements.[54] Those press releases, presentations, and conference calls all contain meaningful cautionary language[55] or expressly refer to the risk factors in Freddie Mac's Annual Reports.[56] As discussed above, Freddie Mac's Annual Reports set forth in great detail the numerous risks that could affect Freddie Mac's investments and business, as did the many press releases on which Plaintiff relies. See supra Part III.A.3. In light of these extensive cautionary disclosures, the PSLRA's safe harbor provision or the "bespeaks caution" doctrine precludes Plaintiff's claims.

Certain alleged misrepresentations "are immaterial as a matter of law because it cannot be said that any reasonable investor could consider them important in light of adequate cautionary language": they "bespeak caution" as a matter of law. Halperin v. eBanker USA.COM, Inc., 295 F.3d 352, 357 (2d Cir. 2002); see also Polin v. Conductron Corp., 552 F.2d 797, 806 n.28 (8th Cir. 1977), cert. denied, 434 U.S. 857 (1977) ("Language of expectation, of

[54] See AC ¶¶ 443, 445-49, 453, 454, 460, 462, 472, 474-75, 478-83, 489, 491-93, 496, 501, 504-07, 509-10, 515-16, 519, 525-26, 530, 534, 537, 549-50, 554.

[55] See App. 12 at 4 (Nov. 20, 2007 Press Release); App. 13 at 73-74 (Nov. 20, 2007 Financial Report); App. 14 at 2, 25 (Nov. 20, 2007 Conference Call Tr.); App. 16 at 5-7 (Nov. 29, 2007 Preferred Stock Offering Circular); App. 18 at 13, 1, 73-74 (Dec. 11, 2007 Goldman Sachs Financial Services Summit Tr.); App. 19 at 4 (Feb. 28, 2008 Press Release); App. 7 at 13, 26-27 (2007 Annual Report); App. 20 at 2, 21, 25 (Feb. 28, 2008 Conference Call Tr.); App. 22 at 1, 45, 43 (March 12, 2008 Investor/Analyst Conference Tr.); App. 27 at 6-7 (May 14, 2008 Press Release); App. 28 at 10-11 (May 14, 2008 Financial Report); App. 29 at 1, 16, 31 (May 14, 2008 Conference Call Tr.); App. 30 at 20, 16, 20 (May 20, 2008 Lehman Brothers Financial Services Conference Tr.); App. 31 at 2 (June 6, 2008 Freddie Mac 2008 Annual Stockholder's Meeting Tr.); App. 32 (July 10, 2008 Reuters News Article); App. 33 (July 11, 2008 Press Release); App. 34 (July 13, 2008 Press Release); App. 63 (July 21, 2008 Real Estate Finance & Investment Article); App. 35 (Aug. 4, 2008 Real Estate & Investment Business Article); App. 37 at 49 (Aug. 6, 2008 Conference Call Tr.); App. 38 (Aug. 6, 2008 MarketWatch Report).

[56] In a public disclosure containing forward-looking statements, a corporation may incorporate by reference the risk factors set forth in its recent financial disclosures. See, e.g., Biovail Corp., 615 F. Supp. 2d at 231-33 (considering cautionary language in recent SEC Form 20-F/A in holding that safe harbor immunized from liability all alleged misrepresentations); Miller v. Champion Enters., Inc., 346 F.3d 660, 677-78 (6th Cir. 2003) (holding that forward-looking statement in letter to shareholders could not give rise to liability because letter referenced risk factors in recent Form 10-K).

anticipation, and of possibilities recognizes the imponderable influences of complex variables in a fast-changing field.") (emphasis added).[57] The bespeaks caution doctrine "refers to the use of cautionary language aimed at warning investors of potential risks that may occur in the future." In re Nokia Oyj (Nokia Corp.) Sec. Litig., 423 F. Supp. 2d 364, 400 (S.D.N.Y. 2006). Accordingly, those forward-looking statements that are couched in cautionary language are not actionable as a matter of law. See San Leandro Emergency Med. Group, 75 F.3d at 811. The doctrine also renders inactionable statements that "lack the sort of definitive positive projections that might require later correction." Id. (quoting Time Warner, 9 F.3d at 267). As the Third Circuit has explained, "'bespeaks caution' is essentially shorthand for the well-established principle that a statement or omission must be considered in context, so that accompanying statements may render it immaterial as a matter of law." In re Donald J. Trump Casino Sec. Litig. Taj Mahal Litig., 7 F.3d 357, 364 (3d Cir. 1993), cert. denied, 510 U.S. 1178 (1994) (holding, inter alia, that bespeaks caution doctrine rendered immaterial alleged misrepresentations and omissions).[58]

The PSLRA's safe harbor provision represents a statutory codification of the "bespeaks caution" doctrine. See Helwig v. Vencor, Inc., 251 F.3d 540, 547-48 (6th Cir. 2001). Like the bespeaks caution doctrine, the safe harbor provision requires that "allegedly fraudulent forward-looking statements must be examined in the light of the cautionary language surrounding them." In re Cross Media Mktg. Corp. Sec. Litig., 314 F. Supp. 2d 256, 267 (S.D.N.Y. 2004); see also Halperin, 295 F.3d at 357 (noting that court must analyze the allegedly fraudulent materials in

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[57] See also Herring v. Teradyne, Inc., No. 01-1835, slip op. at 9 (S.D. Cal. Aug. 29, 2008) (applying bespeaks caution doctrine).

[58] In particular, the "bespeaks caption" doctrine precludes Plaintiff's claims with respect to the challenged statements regarding Freddie Mac's capital adequacy, which were necessarily forward-looking. See, e.g., AC ¶¶ 454, 472, 478, 479, 481, 490, 526. Courts have held that statements such as these are forward-looking and therefore protected by the "bespeaks caution" doctrine. See, e.g., Hess v. American Physicians Capital Inc., No. 04-31, 2005 WL 459638 (W.D. Mich. Jan. 11, 2005) (loan loss reserves); In re Aegon N.V. Sec. Litig., No. 03-0603, 2004 WL 1415973 (S.D.N.Y. June 23, 2004) (reserves for bond defaults); In re Kindred Healthcare, Inc. Sec. Litig., 299 F. Supp. 2d 724 (W.D. Ky. 2004) (litigation reserves and loan loss reserves); Harris v. Ivax Corp., 182 F.2d 799 (11th Cir. 1999) (return reserves). Furthermore, as discussed supra Part III.A.3.b, throughout the class period, Freddie Mac consistently disclosed the risk that it would not meet its future capital requirements. See, e.g., App. 13 at 6, 27, 74 (Nov. 20, 2007 Financial Report) ("[W] e might not be able to manage to the 30% target capital surplus."); App. 7 at 14 (2007 Annual Report) ("[W]e might not be able to manage to the mandatory target capital surplus.").

their entirety, including cautionary language). The safe-harbor provision is intended to permit companies to make projections without fear of liability should those projections not come to pass. See, e.g., Biovail Corp., 615 F. Supp. 2d at 231. As the Second Circuit has explained:

> [C]ompanies must be permitted to operate with a hopeful outlook: People in charge of an enterprise are not required to take a gloomy, fearful or defeatist view of the future; subject to what current data indicates, they can be expected to be confident about their stewardship and the prospects of the business that they manage.

Rombach, 355 F.3d at 174 (citations and quotation marks omitted).

To obtain the protections of the PSLRA's safe harbor, companies do not have to predict the future accurately, but rather they must disclose those risks important to their projections. See In re Cytyc Corp., No. 02-12399, 2005 WL 3801468, at *21 (D. Mass. Mar. 2, 2005) ("[T]he cautionary statement does not necessarily have 'to include the particular factor that ultimately causes the forward-looking statement not to come true.'") (citation omitted).

4. Freddie Mac Is Not Liable For The Statements Of Third Parties.

A company (or its management) cannot be liable for statements made by analysts or other third parties, except where a company has "sufficiently entangled itself with the [third party's] forecasts to render those predictions 'attributable to [the company].'" Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 163 (2d Cir. 1980). This "entanglement" exception requires plaintiffs to demonstrate that the third party's statements are attributable to defendants in some way, such as when "officials of the company have, by their activity, made an implied representation that the information they have reviewed is true or at least in accordance with the company's views" or when a company "so involve[s] itself in the preparation of reports and projections by outsiders as to assume a duty to correct material errors in those projections." Id. A plaintiff must plead such "entanglement" with particularity. In re Health Mgmt. Sys. Inc. Sec. Litig., No. 97-1865, 1998 WL 283286, at *2 (S.D.N.Y. June 1, 1998).

5. Characterizations Cannot Replace Actionable Statements.

Plaintiff's Amended Complaint is laden with characterizations in lieu of what Defendants

actually said, and snippets of Defendants' statements that Plaintiff removes from their context and that are not actionable. As courts have held, however, such characterizations lack any legal significance. See Bay Harbour Mgmt. LLC v. Carothers, Nos. 07-1124, 07-1157, 2008 WL 2566557, at *2 (2d Cir. June 24, 2008) (rejecting plaintiff's characterization of challenged statement after reviewing the challenged statement in context, and affirming dismissal of all claims); Melder v. Morris, 27 F.3d 1097, 1100 (5th Cir. 1994) (affirming dismissal of securities fraud class action where "plaintiffs fail[ed] to base their allegations on statements actually made by [defendants], opting instead to selectively distort the company's public statements to create an inference of fraud"); In re Copley Pharm., Inc. Sec. Litig., No. 94-11897, 1995 WL 169215, at *2 (D. Mass. Mar. 16, 1995) (Young, J.) (dismissing securities claims based on allegations that defendants' statements "fostered senses" and created "impressions").

The Second Circuit has rejected securities fraud allegations similar to those asserted here. In Philip Morris, plaintiffs alleged that defendants fraudulently made a number of positive statements before a negative announcement, to inflate the company's stock price artificially. See In re Philip Morris Sec. Litig., 872 F. Supp. 97, 101 (S.D.N.Y. 1995), aff'd in part sub nom. San Leandro Emergency Med. Group, 75 F.3d at 811. Dismissing plaintiffs' claims with prejudice, the court concluded that "the totality of all these statements reflects neither misleading optimism, nor fraud":

> **Disclosure requirements are not intended to "attribute to investors child-like simplicity"**; investors are presumed to have the ability to be able to digest varying reports and data. The total mix of information is determinative, and **the court must assess**, as must investors at the time, **all of the statements** and predictions issued by Philip Morris **in the context, fluid as it was, in which they were made.**

Id. (emphasis added) (citations omitted). On the basis of that well-settled law, the court in Philip Morris carefully analyzed the entire context of each partial statement upon which plaintiffs relied, including the full text of each newspaper article from which plaintiffs had extracted a quotation. Id. at 99-101.[59] After reviewing those statements in full, the court concluded:

[59] In Philip Morris, as here, the plaintiffs had omitted from their complaint key portions of statements upon which they had relied. 872 F. Supp. at 100, 102. Like Defendants here, the Philip Morris defendants put before the

> [F]raud can only be perpetrated upon the market if that market does not have material information or had incomplete or inaccurate information. . . . **<u>Under the efficient market hypothesis the market price of shares traded on a sophisticated market reflects all available information.</u>** **<u>Accordingly, in viewing this complaint, balanced by omitted portions of statements plaintiffs otherwise rely upon, it appears that all material information was available.</u>**

<u>Id.</u> at 102-03 (emphasis added) (citations omitted).

Applying that reasoning, together with the legal principles explained above, to the statements at issue here, reveals that Plaintiff has failed to plead that any of those statements is actionable. The Court will require a machete to cut through the dense jungle of characterizations contained in Plaintiff's Amended Complaint. Putting those mischaracterizations aside, however, none of Defendants' actual statements is actionable, as a matter of law.

C. An Application Of The Foregoing Legal Doctrines To Each Of The Challenged Statements Establishes That None <u>Of The Challenged Statements Is Actionable, As A Matter Of Law.</u>

In its Amended Complaint, Plaintiff challenges as false or materially misleading myriad statements issued between November 20, 2007 and September 7, 2008. A statement-by-statement examination of the challenged statements, however, tells a story that is completely at odds with Plaintiff's misleading distortions. Indeed, the "totality of [the] statements" the Plaintiff relies on here, <u>i.e.</u>, each statement examined in full and in context, "reflects neither misleading optimism nor fraud." <u>See</u> <u>Philip Morris</u>, 872 F. Supp. at 101.

Here, Plaintiff quotes statements set forth in thirty sources, including press releases, financial reports, an annual report, earnings conference calls, investor presentations, newspaper articles and the like. <u>See</u> AC ¶¶ 441-49, 453-54, 458-63, 472-83, 489-93, 496, 501, 504-07, 509-10, 515-16, 519, 525-26, 530, 537, 539, 549-51, 554, 558. None of the challenged statements is actionable, as a matter of law, because each is either: (1) an accurate statement of historical fact that Plaintiff does not challenge as false; (2) a vague and indefinite statement of optimism, which is immaterial as a matter of law; or (3) a statement that is protected by the PSLRA's safe harbor for forward looking statements or that "bespeaks caution" in outlook.

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court "the context and additional parts of plaintiffs' selected quotations," which the court properly considered in dismissing the case. <u>Id.</u>

While this Court must engage in a statement-by-statement analysis of Plaintiff's Amended Complaint to assess whether it has stated a claim based on each alleged misstatement, it is simply not possible to discuss the many alleged misstatements within the confines of this 60-page brief.[60] Nevertheless, the following examples illustrate the deficiencies found in all of the statements that Plaintiff challenges.

Plaintiff alleges that the following statements in Freddie Mac's November 20, 2007 press release were false and misleading: (1) "**[W]e are optimistic** about Freddie Mac's longer-term prospects. The market shift towards fixed rate originations and improved pricing and credit standards **should position us well** as the weakness in credit markets begins to improve and we are able to leverage our traditional strengths."; (2) "During the past year we have taken important steps to address the impact of the declining housing and credit markets to our business . . . . These actions **position us well** to take advantage of opportunities when the current market dislocation ends."; and (3) "Freddie Mac's regulatory core capital was estimated at $34.6 billion at September 30, 2007 . . . . Estimated regulatory core capital was $34.6 billion at September 30, 2007 . . . ." AC ¶ 441 (emphasis added).[61]

None of these statements is actionable, for obvious reasons. Statements that corporate actors "are optimistic" and that their actions "position us well" constitute vague and indefinite statements of optimism, which are immaterial as a matter of law. See supra Part III.B.2. Statements regarding steps taken during the past year are not actionable because they are accurate statements of historical fact that Plaintiff has not challenged as false. See supra III.B.1. In addition, statements regarding capital requirements are a part of Plaintiff's fraud by hindsight allegations, see, e.g., AC ¶ 452, which are not viable as a matter of law, see supra p 2. Nowhere does Plaintiff allege with sufficient particularity how any of these statements is false, much less that any Defendant knew it was false when made. See supra Parts II.A.1, II.B.1.

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[60] A chart of each alleged misstatement and the reasons why that challenged statement is not actionable, as a matter of law, is provided herewith as App. 44.

[61] According to Plaintiff, it alleges that only those statements emphasized in bold italics in the Amended Complaint are false and misleading. See AC at 168 n.42.

Moreover, the statements of optimism were tempered by cautionary remarks that Plaintiff chose to omit or ignore.[62] For example, the press release included the following statements:

- "[T]oday is a troubled housing and credit market. It will take time for this market to turn around. But as it improves, we are optimistic . . . ." See App. 12 at 1 (Nov. 20, 2007 Press Release).
- "The company expects **credit losses to continue to increase for the remainder of 2007 and in 2008**, especially if conditions, such as home prices and the rate of home sales, continue to deteriorate." Id. at 3 (emphasis added).
- "[V]arious factors, including changes in market conditions, liquidity, mortgage-to-debt OAS or credit outlook . . . could cause actual results to differ materially from these expectations." Id. at 4.

In context, the challenged statements bespeak caution in outlook. See supra Part III.B.3.

As this Court will find, these non-actionable statements are but the tip of the iceberg. Plaintiff's allegations are replete with lengthy quotations from press releases, annual reports, conference calls, and the like, which are quite negative regarding Freddie Mac's performance and prospects, and, in any event, are not actionable under Section 10(b), as a matter of law.

IV. PLAINTIFF'S SECTION 20(a) "CONTROL PERSON" CLAIMS SHOULD BE DISMISSED.

To plead "control person" liability under Section 20(a), Plaintiff must allege: "(1) a primary violation by a controlled person; (2) control of the primary violator by the defendant; and (3) that the [controlling person] was in some meaningful sense a culpable participant in the controlled person's fraud." ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 108 (2d Cir. 2007). Plaintiff has failed to allege any of these elements, and it therefore has failed to state a claim for violation of Section 20(a), as a matter of law. Id.

CONCLUSION

For all of the foregoing reasons, the Amended Complaint should be dismissed, with prejudice. See Malin v. XL Capital, Ltd., No. 07-3749, 2009 WL 481897, at *2 (2d Cir. Feb. 26, 2009) (affirming denial of leave to replead putative securities class action).

[62] Defendants refer the Court, in the first instance, to the full text of each statement at issue, contained in Freddie Mac's Appendix.

Respectfully submitted,

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